

BEFORE THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

APPEAL NO. 35497

TRADERS BANK,

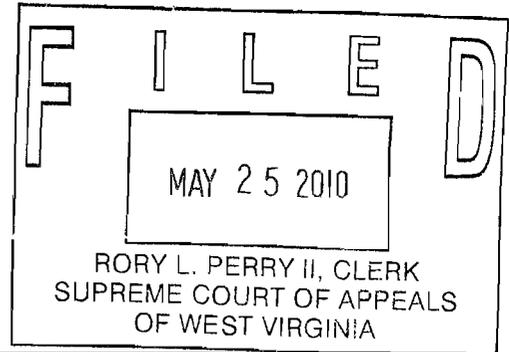
Appellant,

v.

**Circuit Court of Roane County
Civ. Action No. 06-C-1 N
(Honorable David W. Nibert, Judge)**

**SHERMAN DILS III,
PAMELA DILS, and
DILS RENTAL, INC.,**

Appellee.



**REPLY OF APPELLANT UPON CERTIFIED QUESTION
FROM THE CIRCUIT COURT OF ROANE COUNTY**

Presented by:

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INTRODUCTION

The certified question before This Honorable Court, as most things drafted by committee and born of compromise, is not a model of clarity. It is too long and crowded with facts and allegations; but, at its core, it poses an important and yet unanswered question:

May a sophisticated borrower avoid contractual obligations undertaken by him by alleging a new oral term to the contract, which term benefitted solely an unrelated third party, and calling the non-fulfillment of that term a fraudulent inducement?

Appellees accuse Traders Bank (“Traders”) of trying to change the focus of this case. This is incorrect; Traders is trying to clarify the issues.

Those issues involve (i) whether Mr. Dils, a sophisticated commercial borrower, may circumvent an integration/merger clause in a promissory note by pleading fraud in the inducement, (ii) whether the fraud he has pled is actionable, and (iii) whether he has standing to assert breach of an alleged oral promise benefitting solely his son’s (Brett Dils’) Dealership. The answer to each question is no. In the context of the facts of this case, Mr. Dils may not circumvent the contractual integration/merger clause because this was a commercial transaction between sophisticated parties who are bound by their written agreements—avoiding a “swearing match” about additional terms; the fraud pled by Mr. Dils is not actionable because the allegations of Traders’ “state of mind” as it related to its alleged promise do not rise to fraud; and Mr. Dils has no standing to bring his fraud claims because his defenses and Counterclaim in this case rest entirely on the damages allegedly suffered by a third party donee beneficiary.

FACTUAL ISSUES

While challenging the Dils' thirteen pages of factual allegations would be cumbersome and unproductive, Traders is compelled to provide a brief response to two of the most egregious statements and characterizations because they are relevant to Traders' legal argument.

First, no matter how the Dils' spin it, the simple fact is that Mr. Dils executed the \$1,110,000 promissory note ("Note") because his son Brett took \$1,110,000 of Traders' collateral and then tried to cover the loss with false documents. (See Br. of Appellant, pp. 3-4.) From pages 5 to 9 of Appellees' Brief, the Dils make excuses for their son's defalcation by alleging that Traders' supposedly lax loan oversight permitted him to take their collateral—akin to defending a burglar on the theory that he entered through an unlocked door.

Even assuming that the only Floor Plan checks performed from 1999 through 2004 are those for which Traders was able to produce documentation (see Br. of Appellees, p. 6), that Brett Dils did not regularly and repeatedly approach Traders asking it to finance some new business scheme (see id.), that Brett Dils did not somehow convince Ford in 2003 to leave on his lot wrongly-delivered new vehicles that Traders had declined to finance (see id. at p. 7), and that bank employee (and Brett Dils' pal) Larry Tracey did not lead Traders to believe he was actually visiting the Dealership to conduct Floor Plan checks during the last quarter of 2003 (see id.), it is ridiculous for the Dils to try to blame Traders for Brett's illegal conduct by claiming that Traders failed to exercise contractual

risk management prerogatives. Further, it is directly contrary to an express provision of the Floor Plan agreement.¹

Second, because nobody—neither the Dils, nor Brett, nor the Dealership—ever complained in writing (even in an e-mail!) that Traders had failed to “fully” reinstate the Floor Plan, as it now allegedly promised to do, the Dils believe it helps their cause to show that they hired a lawyer to represent them. (See Br. of Appellees, p. 13.) But their sworn affidavits demonstrate that they hired that lawyer (“to negotiate with Traders”) almost a year after the execution of the Note and *long* after the initial maturities of the Note and Floor Plan had passed. (See Aff. of Sherman Dils, III at ¶¶ 15-17 & Aff. of Sherman Dils, IV at ¶ 10, Exs. 19 & 20 to Defs.’ Resp. to Traders Bank’s Mot. to Dismiss & Mot. for Summ. J.) They do not, and truthfully cannot, go further to state that that lawyer asserted a breach of any kind. These uncontroverted failures to formally complain are strong support for Traders’ contention that there was no breach—because there was no promise—and that the fraud alleged, the first written assertion of which was in this civil action, is nothing more than a pretext.

¹ The Loan and Security Agreement for the Floor Plan provides that “[t]he waiver by either party of any breach of any term or condition of Agreement, or the failure to enforce any provision hereof shall not operate as a waiver of any other provision, nor constitute or be deemed a waiver of any rights, in law or in equity, or claims which Bank may have against Borrower for anything arising out of, connected with, related to or based upon this Agreement.” Defs.’ Resp. to Traders Bank’s Mot. to Dismiss & Mot. for Summ. J., Ex. 4, ¶ 46.

THE INTEGRATION CLAUSE

The integration/merger clause in the Note² precludes the Dils' fraud claim. The Dils claim that if this is true, it would eliminate all causes of action for fraud in the inducement because "any claim for fraud in the inducement of a contract would automatically be converted into a breach of contract claim and, as such [be] defeated." (Br. of Appellees, p. 4). But the claims in Davis v. Alford and Dyke v. Alleman,³ on which the Dils rely, were not defeated – where the contract was oral, not a business contract, and not between two sophisticated parties⁴ and where, most important, the party injured by the alleged fraud was *actually before the court*. The demise of fraud in the inducement described by the Dils is premature.

Characterizing the alleged fraudulent promise as part of a contract (see Br. of Appellees, p. 3), i.e., the Dealership's Floor Plan, is exactly what Traders intends. It is not a "recasting" of Mr. Dils' claim (see Br. of Appellee, p. 3) for some malevolent purpose but simply an acknowledgment of the economic loss doctrine, which states that once a bargain is struck and contract terms are agreed upon, a party to the contract (or

² "11. MISCELLANEOUS . . . This Note represents the complete and integrated understanding between Borrower and Lender regarding the terms hereof."

³ Davis v. Alford, 113 W. Va. 30, 166 S.E. 701 (1932) and Dyke v. Alleman, 130 W. Va. 519, 44 S.E.2d 587 (1947).

⁴ The significance of these facts is that where a deal is not a business transaction memorialized in writing, the parties often do not undertake to:

- make purposeful judgments about the risks they should bear and the due diligence they should undertake;
- price factors such as limits on liability;
- consider how committing a fraud or making a misrepresentation could affect their reputation in the marketplace;
- consider contracting away the possibility of certain legal relief so as to limit liability and costs;
- consider including an integration clause stating that the parties are relying only on contractual representations and that no other representations have been made; or
- think about the ramifications of a failure to bargain for a specific condition or warranty.

someone trying to stand in its shoes) should not be able to circumvent the contract terms via tort.⁵ The purpose of the doctrine is not to *bar recovery* for economic losses but to prevent parties from recovering in tort to extricate themselves from prior, freely negotiated agreements.

There are certainly exceptions to the economic loss doctrine,⁶ but such exceptions are applied narrowly. For example, a number of courts hold that where the fraud or misrepresentation alleged is interwoven with performance of the contract and not extraneous to its subject matter, it should not be an exception to the economic loss doctrine. See, e.g., Dinsmore Instrument Co. v. Bombardier, Inc., 199 F.3d 318 (6th Cir. 1999) (construing Michigan law).⁷ Courts have also found that the exception to the rule

⁵ West Virginia recognized the economic loss doctrine in Star Furniture Co. v. Pulaski Furniture Co., 171 W. Va. 79, 297 S.E.2d 854 (1982) (deciding not to extend strict liability to mere loss in value or lost profits cases where fire caused by allegedly defective clock resulted in consequential economic loss) and has applied it in a number of contexts since then. See, e.g., Basham v. General Shale, 180 W. Va. 526, 377 S.E.2d 830 (1988) (reaffirming applicability of economic loss rule to commercial transactions in tort case attempted against manufacturer of allegedly defective bricks seeking costs associated with having bricks replaced); Silk v. Flat Top Construction, Inc., 192 W. Va. 522, 453 S.E.2d 356 (1994) (finding that general contractor could not recover in tort for cost overruns and delay where allegations of subcontractor's failure to perform arose solely under a supervisory consultant agreement); see also Roxalana Hills, Ltd. v. Masonite Corp., 627 F.Supp. 1194 (S.D. W. Va. 1986) (finding where contractor brought action against manufacturer of allegedly defective siding that under West Virginia law, contractor could not recover under strict liability theory for economic loss, i.e., the risk that the product would not last as long as expected); National Steel Erection, Inc. v. J.A. Jones Construction Company, 899 F.Supp. 268 (S.D. W. Va. 1995) (finding that West Virginia's economic loss rule would preclude construction subcontractor from recovering against supervisor for overruns and delays allegedly due to supervisor's negligent design and project administration where subcontractor was not in contractual privity with supervisor).

⁶ See, e.g., First National Bank of Bluefield v. Crawford, 182 W. Va. 107, 386 S.E.2d 310 (1989) (recognizing an exception where the alleged tortfeasor, one who is in the business of supplying information for the guidance of others in their business, does so negligently).

⁷ The court found regarding plaintiff's fraudulent misrepresentation claim (i.e., that defendant A's real motive had been to steal plaintiff's trade secrets and to drive it out of business, and that defendant B had interfered with plaintiff's and defendant A's contractual relationship in an attempt to improve its own business relationship with defendant A) that its expectations were frustrated because the deal it had negotiated was not working properly and that its remedy was in contract alone, for it had suffered only economic losses. Id. at 320; see also Werwinski v. Ford Motor Company, 286 F.3d 661 (3d Cir. 2002) (determining amount in controversy, predicting that Pennsylvania law would prohibit fraudulent concealment and unfair trade practices claims brought to recover economic damages).

should be more narrowly applied where contracting parties are sophisticated business people. See, e.g., Abry Partners V, L.P. v. F & W Acquisition LLC, 891 A.2d 1032, 1061 (Del. Ch. 2006).

Fraud claims are easy to allege, hard to dismiss on a pre-discovery motion, difficult to disprove without expensive, lengthy litigation, and susceptible to the erroneous conclusions of judges and juries. Further, and ironically, it may be the one alleging the fraud who is the actual perpetrator—not the party against whom the fraud is alleged. Here, the promise alleged is interwoven with performance of the Floor Plan.⁸ It is alleged by someone who can be expected to know that all materials terms of a contract are in writing. It is the entire *context* in which the alleged promise arises that makes it inactionable at the instance of Mr. Dils.

ACTIONABLE FRAUD

The Dils' fraud claim asserted in their Counterclaim is insufficient. The sole paragraph in the Dils' counterclaim describing Traders' alleged state of mind (on which the Dils base their fraud case) is paragraph 15, which reads:

15. Because Traders Bank knew that its conduct in connection with administering the Floor Plan Agreement was under investigation and was deemed deficient, Traders Bank knew or should have known that it would be unwilling or unable to reinstate the Floor Plan Agreement with the Dealership even if Mr. Dils cured the out of trust obligation by signing a promissory note for \$1,110,000.00.

(Answer and Countercl. of Defs. Sherman Dils, III, Pamela Dils and Dils Rental, Inc., p.

⁸ The promise alleged to have been made—that Traders Bank in the future would fully reinstate Brett Dils' Dealership's Floor Plan if Mr. Dils would cover the Dealership's out-of-trust obligation—relates directly to the terms of an existing business contract, the Dealership's Floor Plan. The alleged promise relates only tangentially to the contract (Mr. Dils' Note, also a business contract) it is alleged to have induced.

8.) The Dils claim that this allegation satisfies the elements of fraud articulated in Horton v. Tyree, 104 W. Va. 238, 22, 139 S.E. 737 (1927) and Chamberlaine & Flowers, Inc. v. McBee, 177 W. Va. 755, 356 S.E.2d 626 (1987), both of which are fraudulent misrepresentation cases rather than fraudulent promise cases. They say that paragraph 15 is enough for the case at bar; but their allegation that Traders was “in a position to know” or “had a duty to know” that it would not perform the alleged promise (see Br. of Appellees, p. 23) falls short of the standard established by this Court for inducing, fraudulent promises.⁹

Contrary to the Dils’ assertion (see Br. of Appellees, p. 3), Traders is not raising whether fraud is actionable “for the first time in the case.” Whether fraud is actionable is part and parcel of question presented. It arises with the Dils’ reliance on Davis and Dyke, *infra* p.4, to contest the standing/subject matter jurisdiction defense that Traders raises; it arises in light of the factual context of the case at bar; and it arises because this Court is likely to ask who is the proper party to assert the injury alleged and, perhaps, what that party’s cause of action would be.¹⁰

⁹ Fraud in the inducement arises under an exception to the general rule that a fraud cannot be based upon a promise to be performed in the future, which exception states that a fraud may be so premised “when the maker of a promise did not intend to keep it at the time it was made.” See Cottrell v. Nurnberger, 131 W. Va. 391, 407, 47 S.E.2d 454, 463 (1948). With regard to fraudulent inducement through a misrepresentation of existing fact, one holds a duty to know that the things he represents as existing facts are true. See Osborne v. Holt, 92 W. Va. 410, 415-16, 114 S.E. 801, 803 (1922) (affirming judgment for plaintiffs on a fraudulent representation claim regarding corporate stock sold to raise money to purchase land about which certain claims were made as an inducement to making the subscriptions). With regard to fraudulent inducement through a promise to do something in the future, one holds a duty to refrain from making a promise *one knows at the time of making he will not perform*. See Croston v. Emax Oil Co., 195 W. Va. 86, 464 S.E.2d 738 (1995) (emphasis added). Alleging the latter requires that there be a basis for claiming that the defrauder had no intention of performing the promise when it made the promise.

¹⁰ Interestingly, both Dyke and Davis are front and center in this Court’s analysis of Cottrell v. Nurnberger, cited by the Dils (see Br. of Appellees, p. 21), in which it was held that the non-performance of an oral promise to be performed in the future made to induce plaintiffs to enter into a written contract for the purchase of property in a

If the Dils are correct that this Honorable Court, while considering a fraud in the inducement claim, has “[n]ever ma[d]e a distinction regarding whether the . . . contract . . . is a written contract or an oral contract” (see Br. of Appellees, p. 20) or concerning a contract-inducing promise made in a business setting involving only sophisticated contracting parties, that means only that this case presents issues of first impression. It does not follow that the factual predicates do not matter—they do; and it is necessary for the Court to consider the context of this case, which is unlike any other in which this Court has reviewed a judgment or ruling relating to an alleged fraudulent promise.

STANDING

The Dils seek rescission of the Note and “money damages to compensate for additional assistance rendered to [the Dealership] as it failed, allegedly as a result of Traders Bank’s broken promise.” (See 9 October 2008 Order [denying motion to dismiss fraud claim and finding motion for summary judgment premature], ¶ 2.) The Dils do not have standing to recover the relief requested because the injuries alleged to have flowed from the alleged broken promise (if it were sufficiently pled) are damages of the Dealership as a donee beneficiary of the Note; the Dils are not the real party in interest.

In response to Traders’ contention, the Dils are adamant that Mr. Dils expected repayment of the Note by the Dealership. (See Br. of Appellees, p. 16). Yet, the Dils have admitted that Mr. Dils received no agreement from the Dealership to repay him. (Sherman Dils, III’s Answer to Interrog. 25, Ex. A to Mem. Supp. Traders Mot. to

subdivision did not amount to fraud or create an estoppel that took the promise outside the Statute of Frauds. 131 W. Va. 391, 406-07, 47 S.E.2d 454, 462 (1948). In other words, plaintiffs could not plead in tort to obtain what they had failed to get in writing in their purchase agreement.

Dismiss & Mot. for Sum. J.) Nowhere in the Dils' Brief do they allege that the Dealership even orally promised or agreed to repay Mr. Dils. Thus, his direct claim against Traders resides in his hope and expectation, not in any legally enforceable document or promise.

His claim against Traders must be that of the Dealership—that Traders did not extend the full amount of the Floor Plan line of credit, resulting in the Dealership's demise. As stated in Traders' original Brief, that claim was not his to assert; it belonged to the Dealership, which did not assert the claim. Mr. Dils did not suffer the alleged injury from the alleged breach—the Dealership did. Under the principles enumerated in Justice Davis' concurring opinion in Abraham Linc Corp. v. Bedell,¹¹ he cannot assert a claim against Traders for the Dealership's injury.

CONCLUSION

Where (1) it is alleged that an oral promise by a lender induced a written business contract (Mr. Dils' Note) but (2) where the substance of the promise was already a material term of another written business contract (the Dealership's Floor Plan) and (3) the damages alleged (failure of the Dealership) flow from the lender's partial or non-performance of that term, and (4) where there is no legally-recognized connection between the injury alleged and those who appear to assert the breach, the claim must end because the court lacks subject matter jurisdiction over it. The Dils have no standing to bring a fraud action against Traders because their defenses and Counterclaim rest entirely

¹¹ 216 W. Va. 99, 112, 602 S.E.2d 542, 555 (2004) (Davis, J., concurring).

on damages allegedly suffered by the Dealership, which was a third party, donee beneficiary.

TRADERS BANK

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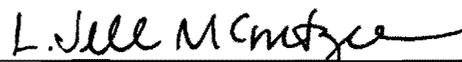
**SHERMAN DILS III,
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Appellee.

CERTIFICATE OF SERVICE

I, L. Jill McIntyre, counsel for the Appellant, do hereby certify that a true and exact copy of the attached **Reply of Appellant upon Certified Question from the Circuit Court of Roane County** was served upon counsel for Appellee by United States mail, postage prepaid, this **25th day of May, 2010**, addressed as follows:

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