No. 20170591-SC

IN THE
SUPREME COURT OF THE STATE OF UTAH

HEALTHBANC INTERNATIONAL, LLC AND BERNARD FELDMAN
Plaintiffs and Counterclaim Defendants,

v.

SYNERGY WORLDWIDE, INC. AND NATURE SUNSHINE PRODUCTS, INC.,
Defendants and Counterclaim Plaintiffs.

BRIEF OF PLAINTIFFS AND COUNTERCLAIM DEFENDANTS

Certified question from the United States District Court for the District of Utah
District Court No. 2:16-cv-00135-JNP-PMW

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LIST OF ALL CURRENT AND FORMER PARTIES

The current and former parties to this appeal are as follows: HealthBanc International, LLC; Bernard Feldman; Synergy Worldwide, Inc.; Nature's Sunshine Products, Inc.; Dan Norman; Richard Strulson; and Steven Bunker.

On this appeal, Mark F. James and Mitchell A. Stephens of the law firm Hatch, James & Dodge, P.C. and Anabella Q. Bonfa and Scott W. Wellman of the law firm Wellman & Warren LLP represent HealthBanc International, LLC and Bernard Feldman. Kimberly Neville and Chris Martinez of the law firm Dorsey & Whitney LLP represent Synergy Worldwide, Inc. and Nature's Sunshine Products, Inc. Dan Norman, Richard Strulson, and Steven Bunker are not parties to this appeal.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Pages(s)

Statutes/Codes

Other

ADDENDA

Tab

A. Royalty Agreement (September 20, 2006) [R.88].

B. Amended Complaint (August 8, 2016) [R.185].

C. Second Amended Counterclaim (October 7, 2016) [R.315].

D. Motion to Dismiss and for Partial Summary Judgment – Exhibits Excluded (October 27, 2016) [R.332].

E. Memorandum in Opposition to Motion to Dismiss and for Partial Summary Judgment – Exhibits Excluded (November 21, 2016) [R.385].

F. Order Certifying Question to the Utah Supreme Court (July 6, 2017) [R.516].

STATEMENT OF JURISDICTION

The subject of this appeal is a certified question from the United States District Court for the District of Utah. This Court issued an Order accepting the certified question on August 17, 2017. This Court has jurisdiction to answer certified questions under Utah Code § 78A-3-102(1).

STATEMENT OF THE ISSUE

Certified Question: "Does Utah's economic loss rule apply to a fraudulent inducement claim?"[1] Specifically, when a fraudulent inducement claim is based on a representation and warranty provision contained in a contract, does Utah's economic loss rule bar that tort claim?[2]

Standard of Review: "A certified question from the federal district court does not present [this Court] with a decision to affirm or reverse a lower court's decision; as such, traditional standards of review do not apply. On certification, [this Court] answer[s] the legal questions presented without resolving the underlying dispute." *Egbert v. Nissan N. Am., Inc.*, 2007 UT 64, ¶7, 167 P.3d 1058 (citations and internal quotation marks omitted).

STATEMENT OF THE CASE

A. Overview

This appeal is the result of the United States District Court for the District of Utah (Judge Parrish) certifying a question of Utah law. Only the facts necessary to provide a context for the certified question are addressed herein.

B. Relevant Parties & Claims

This appeal centers around a September 20, 2006, Royalty Agreement whereby Plaintiff HealthBanc International, LLC ("HealthBanc") sold a "Greens Formula" to

[1] Order Certifying Question (R.516).

[2] This second formulation of the certified question is provided to assist this Court in considering the question in the context of the facts of the case. Judge Parrish's order invited this Court to "reformulate these questions." *Id.*

Defendant Synergy Worldwide, Inc. ("Synergy") for use in Synergy's multilevel marketing business. [*See* Am. Complaint (R.185) at ¶¶36-154]. A copy of the Royalty Agreement has been included as Tab A in the Addenda. [*See* R.88]. The Royalty Agreement is a fully integrated contract. [*See* Royalty Agreement (R.88) at § 11(a) ("This Agreement . . . constitute[s] the entire agreement between the parties with respect to the subject matter described herein.")].

The terms of the Royalty Agreement are simple. HealthBanc assigned its rights in the Greens Formula to Synergy. [Royalty Agreement (R.88) at §1]. Synergy agreed that it would pay HealthBanc a royalty "equal to One Dollar and Seventy Five Cents ($1.75) per 150 gram bottle of the Greens Formula which is sold by Synergy." [*Id.* §3(a)]. Importantly, for purposes of the current appeal, HealthBanc also made the following representation and warranty:

> HealthBanc hereby represents and warrants that it is the sole and exclusive owner of the entire rights, title and interest, including without limitation all patent, trademark, copyright and other intellectual property rights, in and to the Greens Formula . . . free and clear of all liens, claims or encumbrances.

[*Id.* §6(d)].

On February 19, 2016, HealthBanc filed suit. HealthBanc alleges that Synergy "mailed a monthly royalty check along with a summary that purportedly reflected all units of the Greens Formula it sold during the previous month." [Am. Complaint (R.185) at ¶66]. Consistent with the monthly summary, HealthBanc was told the Greens Formula was being sold in Australia and the United States. In September 2013, Synergy accidentally sent HealthBanc a different summary named "Healthbanc Korea Accrual."

[*Id.* ¶¶71-75]. As a result, HealthBanc discovered that Synergy had sold at least "218,246 units of the Greens Formula in Korea" but had failed to pay HealthBanc the required royalty. [*Id.* ¶¶85]. HealthBanc further discovered that other royalty payments also had not been made, including for product sales in Korea, Mexico, and New Zealand. [*See, e.g. id.* ¶¶99]. Accordingly, HealthBanc sued Synergy for breach of contract, among other claims. [*See generally id.* ¶¶147-212].

On October 7, 2016, Synergy filed its Second Amended Counterclaim. In that counterclaim, Synergy alleged that the "parties' representatives negotiated, over the phone and via e-mail, a form of Royalty Agreement that would permit Synergy to acquire the Specified Greens Formula in exchange for an agreed upon royalty." [2d Am. Counterclaim (R.315) ¶8]. "The proprietary nature of the Specified Greens Formal was" material to Synergy. "Accordingly, Synergy specifically requested that HealthBanc provide certain representations and warranties" in the Royalty Agreement. [*Id.* ¶10]. Synergy's allegations material to the fraud claim at issue on this appeal are as follows:

> 11. Specifically, in September 2006, Synergy requested revisions to an earlier draft of the Royalty Agreement to include specific representations and warranties regarding HealthBanc's ownership rights. ***These revisions were eventually incorporated into Paragraph 6(d) of the Royalty Agreement, in which HealthBanc "represents and warrants that it is the sole and exclusive owner of the entire rights, title and interest, including without limitation all patent, trademark, copyright and other intellectual property rights, in and to" the Specified Greens Formula***. These revisions were sent via email to Bernard Feldman [HealthBanc's representative] for his review.
>
> 12. On September 7, 2006, Jonathan Young from Synergy spoke on the telephone with Bernard Feldman about the draft Royalty Agreement. By this time, Mr. Feldman had reviewed the draft Royalty Agreement in which it was made clear that Synergy required Mr. Feldman and

> HealthBanc to represent and warrant their ownership of their "entire rights, title and interest, including without limitation all patent, trademark, copyright and other intellectual property rights, in and to" the Specified Greens Formula. In that same September 7, 2006 phone conversation, ***Mr. Feldman discussed the draft Royalty Agreement with Mr. Young and Mr. Feldman requested certain changes to the draft Royalty Agreement. Mr. Feldman did not, however, ask for any changes to the representations and warranties*** concerning HealthBanc's ownership of intellectual property rights. Moreover, Mr. Feldman omitted and failed to disclose to Mr. Young that HealthBanc did not own intellectual property rights in the Specified Greens Formula.
>
> 13. Subsequent to that conversation, ***the Royalty Agreement was revised again but the representations and warranties concerning HealthBanc's ownership of intellectual property rights remained in the Royalty Agreement.*** The revised Royalty Agreement was sent to Mr. Feldman on September 20, 2006 via email. On November 2, 2006, Mr. Feldman contacted Denise Bird via telephone. In that phone call, he indicated he was ready to sign the Royalty Agreement and he again omitted and failed to disclose that HealthBanc did not own intellectual property rights in the Specified Greens Formula.
>
> . . . .
>
> 16. ***The parties' discussions were ultimately memorialized into a written Royalty Agreement dated September 20, 2006*** and signed by Mr. Feldman.

[*Id.* ¶¶11-13, 16 (emphases added)].

Synergy's Second Amended Counterclaim includes a breach of contract claim based upon the allegation that "HealthBanc has breached Paragraph 6(d) of the Royalty Agreement, in which HealthBanc 'represents and warrants that it is the sole and exclusive owner of the'" Greens Formula and all associated intellectual property rights. [*Id.* ¶55]. Synergy also asserts a substantially identical claim for fraudulent inducement. [*See id.* at ¶¶61-71]. In that claim, Synergy alleges that HealthBanc misrepresented it "had the

exclusive right to use, assign or sell the Specified Greens Formula and its associated intellectual property rights." [*Id.* ¶61].

C. Procedural History

HealthBanc contends that Synergy's fraud claim fails for a number of different reasons. For example, Synergy has misinterpreted the representation and warranty at issue.[3] Synergy's alleged fraud claim also is barred by the applicable statute of limitations. *See* Utah Code Ann. § 78B-2-305. [*See also* 5/22/17 Transcript at 37-38 (quoting Synergy 30(b)(6) Dep.) ("[Q.] When did you first become aware that there was any issue with property rights in the product? A. When I started reviewing the contract . . . around '07 or '08.")].

On October 27, 2016, HealthBanc filed a Motion to Dismiss and for Partial Summary Judgment seeking to dismiss Synergy's fraud claim based on the statute of limitations. [*See generally* MSJ (R.332)]. Synergy filed a Memorandum in Opposition on November 21, 2016. In that memorandum, Synergy walked away from a portion of the

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"Representation and Warranties of HealthBanc"	
"HealthBanc hereby represents and warrants that it is the sole and exclusive owner of the entire rights, title and interest, including without limitation all patent, trademark, copyright and other intellectual property rights, in and to the Greens Formula . . . free and clear of all liens, claims and encumbrances." [Royalty Agreement (R.88) at §6(d)].	
HealthBanc's Interpretation	**Synergy's Interpretation**
No party other than HealthBanc can claim an ownership interest in the Greens Formula. Rather, HealthBanc is the owner of that formula and can convey good title.	HealthBanc represented that the Greens Formula qualified for protection under the law as a "patent, trademark, copyright" or trademark.

fraud claim it originally pled by limiting its claim to "HealthBanc's [alleged] misrepresentation regarding its alleged ownership of the Greens Formula and associated intellectual property." [MSJ Opp. (R.385) at ii]. Synergy then offered the following "facts" that it claims give rise to its fraudulent inducement claim:

> 4. ***The proprietary nature of the Specified Greens Formula was a material representation to Synergy***, as it would potentially allow Synergy to make additional promotional claims in the marketplace and / or potentially exclude competitors who attempted to market similar products. ***Accordingly, Synergy specifically requested that HealthBanc provide certain representations and warranties regarding the alleged proprietary nature of the formula***.
>
> 5. ***Specifically, in September 2006, Synergy requested revisions to an [sic] draft of the Royalty Agreement*** to include specific representations and warranties regarding HealthBanc's ownership rights. ***These revisions were eventually incorporated into Paragraph 6(d) of the Royalty Agreement***, in which HealthBanc "represents and warrants that it is the sole and exclusive owner of the entire rights, title and interest, including without limitation all patent, trademark, copyright and other intellectual property rights, in and to" the Specified Greens Formula. These revisions were sent via email to Bernard Feldman for his review.
>
> 6. In the following weeks, Synergy's representatives spoke on the telephone with Bernard Feldman about the draft Royalty Agreement on multiple occasions. Mr. Feldman requested certain changes to the draft Royalty Agreement during these conversations. Mr. Feldman did not, however, ask for any changes to the representations and warranties concerning HealthBanc's ownership of intellectual property rights. Consequently, ***the representations and warranties concerning HealthBanc's ownership of intellectual property rights remained in the Royalty Agreement***.
>
> 7. ***The proprietary nature of the formula was a material term of the Royalty Agreement*** that affected the overall terms of the transaction. Indeed, at one point, Mr. Feldman argued that Synergy should pay HealthBanc up to $4.00 / canister as a royalty, in order to gain access to HealthBanc's team of scientists and experts that had developed the Specified Greens Formula.

> 8. As a result of HealthBanc's representations over its ownership of intellectual property rights in and to the Specified Greens Formula, Synergy agreed to pay a royalty fee of $1.75 / canister, which was substantially above-market for a product of this nature. Synergy agreed to the generous fee, in large part, because it believed that is was purchasing a proprietary formula that had at least some attaching intellectual property rights and related scientific support.
>
> 9. ***The parties' discussions were ultimately memorialized into a written Royalty Agreement dated September 20, 2006***, which was signed by Mr. Feldman.

[MSJ Opp. (R.385) at vi-vii (emphases added)].

Oral argument on HealthBanc's Motion to Dismiss and for Partial Summary Judgment was scheduled for May 22, 2017. Although HealthBanc's summary judgment motion had not argued the economic loss doctrine, the trial court issued a minute entry instructing that "the parties should be prepared to address whether this court should certify to the Utah Supreme Court the question of whether Utah[']s economic loss rule applies to a fraudulent inducement claim."[4] [*See* Minute Entry, Dkt. 87]. HealthBanc argued that the question should not be certified. The trial court disagreed and entered its Order of Certification on July 6, 2017. [*See* Order of Certification (R.516)].

[4] HealthBanc's ninth affirmative defense contends that Synergy's claim is "barred by the economic loss doctrine." [*See* Answer to 2d Am. Counterclaim (R.376)]. HealthBanc also had moved to dismiss Synergy's original counterclaim based on the economic loss doctrine. HealthBanc, however, had not yet sought dismissal of Synergy's Second Amended Counterclaims based on the economic loss doctrine.

SUMMARY OF ARGUMENT

"We might say that what is happening is that 'contract' is becoming reabsorbed into the mainstream of 'tort.' Until the general theory of contract was hurriedly run up late in the nineteenth century, tort had always been our residual category of civil liability. As the contract rules dissolve, it is becoming so again."

Grant Gilmore, *The Death of Contracts* 87 (1974)

"The economic loss rule is a judicially created doctrine that marks the fundamental boundary between contract law . . . and tort law." *SME Indus., Inc. v. Thompson, Ventulett, Stainback & Assocs., Inc.*, 2001 UT 54, ¶32, 28 P.3d 669, *holding modified on other grounds by Sunridge Dev. Corp. v. RB & G Eng'g, Inc.*, 2010 UT 6, 230 P.3d 1000. "[T]ort law should govern the duties and liabilities imposed by legislatures and courts upon non-consenting members of society, and contract law should govern the bargained-for duties and liabilities of persons who exercise freedom of contract." *Grynberg v. Questar Pipeline Co.*, 2003 UT 8, ¶41, 70 P.3d 1.

In this case, the parties spent months negotiating the terms of their Royalty Agreement. According to Synergy, it required that the final contract include "certain representations and warranties regarding the alleged proprietary nature of the formula." [*See* MSJ Opp. (R.385) at vi-vii]. That specific language was drafted, exchanged, and negotiated as part of the overall agreement. [*Id.*]. Indeed, the Royalty Agreement declares that it "constitute[s] the entire agreement between the parties with respect to the subject matter described [there]in" – there were no agreements or promises outside of that contract. [*Id.*]. *See generally DCH Holdings, LLC v. Nielsen*, 2009 UT App 269, ¶8, 220 P.3d 178 ("[P]arol evidence rule operates 'to exclude [extrinsic] evidence of contemporaneous

conversations, representations, or statements for the purpose of varying or adding to the terms of an integrated contract."). As Synergy has acknowledged, "[t]he parties' discussions were . . . memorialized into a written Royalty Agreement dated September 20, 2006." [*Id.*].

Synergy obtained what it requested and negotiated for—a specific, written contract warranty that it drafted and included in the Royalty Agreement. If that provision was breached (HealthBanc contends it was not), Synergy has the contractual remedies for which it negotiated. *See, e.g.*, Restatement (Second) of Contracts §345 (recognizing contract remedies include damages, "specific performance," "restoration," restitution, and release of obligations). Indeed, Synergy has asserted a breach of contract claim on precisely this basis. "[Synergy] complains that it has failed to receive the anticipated benefits of its bargain. Such benefit of the bargain claims are based in contract law and should be governed thereby." *Apollo Grp., Inc. v. Avnet, Inc.*, 58 F.3d 477, 481 (9th Cir. 1995).

Synergy's breach of contract claim is not before this Court. Instead, what is before this Court is Synergy's efforts to enforce HealthBanc's contractual obligations and liabilities through a tort claim for "fraud in the inducement." Although the parties defined the boundaries of their relationship and obligations through a negotiated contract, Synergy asks this Court to make them strangers again by imposing the common law's default tort standards. *See generally* *Grynberg*, 2003 UT 8, ¶43 ("Contractual duties exist by mutual agreement of the parties, while tort duties exist by imposition of society."); *Reighard v. Yates*, 2012 UT 45, ¶19, 285 P.3d 1168 ("Duties may emanate from bargains, and therefore be within the ambit of contract law, and duties may also emanate from the 'interdependent

nature of human society,' in which case they are governed by tort principles."). The Court should decline Synergy's request.

"The economic loss rule prevents recovery of economic damages under a theory of tort liability when a contract covers the subject matter of the dispute." *Reighard*, 2012 UT 45, ¶14. "All contract duties, and all breaches of those duties—no matter how intentional—must be enforced pursuant to contract law." *Grynberg*, 2003 UT 8, ¶43. The Royalty Agreement between HealthBanc and Synergy contains a warranty provision that covers the very subject of Synergy's fraud claim. Synergy's effort to convert a breach of that warranty provision into a tort violates the economic loss rule's protections against converting claims based on breach of contract into claims based on general tort law. Were this Court to rule differently, it would significantly undermine the concept of an integrated contract that governs parties' relationships and rewrite fundamental contract doctrines.

This Court should reaffirm that the economic loss rule bars all tort claims that overlap with the subject matter of the parties' contract.

ARGUMENT

I. The Economic Loss Rule Prevents Tort Claims When the Parties Have Negotiated and Executed a Contract Covering the Subject of the Dispute.

The economic loss rule acts as the demarcation line between tort law, which governs "non-consenting members of society" and contract law, which governs "persons who exercise freedom of contract." *See* *Grynberg v. Questar Pipeline Co.*, 2003 UT 8, ¶41, 70 P.3d 1.

The economic loss rule originated in products liability cases, and its application originally was based solely on the nature of the losses for which the plaintiff sought to recover. *Id.* ¶42. A party could not recover "purely economic losses in non-contractual settings."[5] *Id.* As the economic loss rule expanded beyond products liability, courts shifted their focus from the nature of the losses to the "source of the duty that was breached." *Id.* at ¶43. "Contractual duties exist by mutual agreement of the parties, while tort duties exist by imposition of society." *Id.*; *see also* *Reighard v. Yates*, 2012 UT 45, ¶19, 285 P.3d 1168 ("A duty may arise from one of several sources. Duties may emanate from bargains, and therefore be within the ambit of contract law, and duties may also emanate from the

[5] Utah courts have defined economic losses as follows: "Damages for inadequate value, costs of repair and replacement of the defective product, or consequent loss of profits—without any claim of personal injury or damage to other property . . . as well as the diminution in the value of the product because it is inferior in quality and does not work for the general purposes for which it was manufactured and sold." *Davencourt at Pilgrims Landing Homeowners Ass'n v. Davencourt at Pilgrims Landing, LC*, 2009 UT 65, ¶ 18, 221 P.3d 234.

'interdependent nature of human society,' in which case they are governed by tort principles." (citing 57A AM.JUR.2D Negligence § 82 (1989))).

In a continuation of this evolving principle, this Court recently formulated the rule as follows: "The economic loss rule prevents recovery of economic damages under a theory of tort liability when a contract covers the subject matter of the dispute." *Reighard v. Yates*, 2012 UT 45, ¶14, 285 P.3d 1168, 1174. "This result is compelled because a contract may alter or eliminate common law tort duties." *Id.* ¶20. Thus, in *Reighard*, the plaintiffs purchased a house from the defendant builder and later sued him after they discovered mold in the house. The plaintiffs asserted claims in both contract and tort. On appeal, this Court concluded that the economic loss rule barred plaintiffs' tort-based claims because "[a]ny tort duties" owed to the plaintiffs "overlap[ped] with [defendant's] contract duties to the [plaintiffs]." *Id.* ¶25.

At times, the Court has applied the economic loss rule by asking "whether a duty exists independent of any contractual obligations between the parties." *Id.* ¶21. When asking that question, the Court is not concerned with whether tort-law generally imposes such a duty.[6] Instead, the Court again is asking whether the contract covers the subject of the dispute. In other words, is the alleged tort theory distinct and separable from the negotiated contract. "When a duty exists that does not ***overlap*** with those contemplated in

[6] Indeed, if that were the question, the economic loss rule would be unnecessary. If tort law does not impose a duty, there is no cognizable tort claim. *See, e.g.*, *Kimiko Toma v. Utah Power & Light Co.*, 365 P.2d 788, 791 (Utah 1961) (recognizing one "element[] of every tort action" is "existence of a legal duty"), *overruled on other grounds by Williams v. Melby*, 699 P.2d 723 (Utah 1985).

contract, the economic loss rule does not bar a tort claim because the claim is based on a recognized independent duty of care . . . ." *Id.* (emphasis added). But when the tort claim and the contract claim overlap – i.e., "when a conflict arises between parties to a contract regarding the subject matter of that contract" – "the contractual relationship controls, and parties are not permitted to assert actions in tort." *Id.* ¶20.

Regardless of how the question is asked, the purpose and intent is to determine whether the tort claim is entwined with the contractual agreement. If so, the economic loss rule applies, and the claim is governed by the contract.

In this case, there is no dispute that Synergy's alleged misrepresentation claim overlaps with the Royalty Agreement. Indeed, the alleged representation at issue is found in a warranty provision ultimately included in the contract itself. [*See supra* at Statement of the Case]. Synergy itself admits that "the parties' discussions were . . . memorialized into a written Royalty Agreement," which is an integrated contract. [*See* 2d Am. Counterclaim (R.315) ¶16]. Synergy's misrepresentation claim directly overlaps with the subject and language of the contract. Accordingly, it is barred by the economic loss rule.

II. The Court Should Not Create an Exception for Misrepresentation Claims.

"The Utah Supreme Court has never recognized an exception [to the economic loss rule] for claims of fraudulent inducement." *Donner v. Nicklaus*, 778 F.3d 857, 875 (10th Cir. 2015). To the contrary, federal courts applying Utah law have ruled that both "negligent misrepresentation and fraud . . . are not cognizable under Utah law when they are based on the allegations that are the gravamen of the contract claim." *See, e.g.*, *Wardley Corp. v. Meredith Corp.*, 93 F. App'x 183, 186 (10th Cir. 2004); *see also* *Kaloti*

Enterprises, Inc. v. Kellogg Sales Co., 699 N.W.2d 205, 219 (Wis. 2005) ("[A] fraud in the inducement claim is not barred by the economic loss doctrine 'where the fraud is extraneous to, rather than interwoven with, the contract.'"); *In re Crown-Simplimatic, Inc.*, 299 B.R. 319, 324 (Bankr. D. Del. 2003) ("Because these promises were encompassed in the [contract], [plaintiff's] fraudulent inducement count will be dismissed.").

At times, courts have failed to fully analyze the economic loss rule, which has led to overbroad and confusing statements about how intentional torts are treated.[7] The confusion stems from the courts' failure to recognize that the economic loss rule has two different branches with different triggers and applications. A careful articulation and application of the economic loss rule, however, clarifies any such confusion.

The economic loss rule has two complementary but distinct applications. "First, it bars recovery of economic losses in negligence actions unless the plaintiff can show physical damage to other property or bodily injury." *Sunridge Dev. Corp. v. RB&G Eng'g., Inc.*, 2010 UT 6, ¶28, 230 P.3d 1000. This branch of the economic loss rule applies when there is no contract between the relevant parties. The Restatements helpfully illustrate this first branch:

- "Driver negligently runs over Goalie, who has a contract to play for Employer's hockey team. As a result of the accident, Goalie is unable to perform for the rest of the season, and Employer suffers lost revenue from ticket sales. Employer has no tort claim against Driver."

- "Builder negligently constructs a building for Client. The building collapses as a result, forcing the closure of adjacent streets for several weeks. Delicatessen, which operates next door to the collapsed building, suffers no physical damage but loses

[7] *See, e.g.*, *Lifevantage Corp. v. Domingo*, No. 2:13-cv-1037, 2016 WL 4706389, at *16 (D. Utah Sept. 8, 2016) ("But the rule does not apply to intentional torts.").

> profits because customers cannot reach the entrance while the street is closed. Delicatessen has no tort claim for negligence against Builder for lost profits."

Restatement (Third) of Torts: Liab. For Econ. Harm § 7 TD No 2, Ill. 1, 4 (2014).

Utah courts have recognized that the first branch of the economic loss rule does not apply when an intentional tort, such as misrepresentation, is alleged. "[P]laintiffs may recover purely economic losses in cases involving intentional torts such as fraud, business disparagement, and intentional interference with contract." *SME Indus., Inc. v. Thompson, Ventulett, Stainback & Assocs., Inc.*, 2001 UT 54, ¶32 n.8, 28 P.3d 669, *holding modified on other grounds by Sunridge Dev. Corp. v. RB & G Eng'g, Inc.*, 2010 UT 6, 230 P.3d 1000; *see also Am. Towers Owners Ass'n, Inc. v. CCI Mech., Inc.*, 930 P.2d 1182, 1190 n.11 (Utah 1996), *abrogated on other grounds by Davencourt at Pilgrims Landing Homeowners Ass'n v. Davencourt at Pilgrims Landing, LC*, 2009 UT 65, 221 P.3d 234 ("A plaintiff may, however, recover purely economic losses in cases involving intentional torts, e.g., fraud, business disparagement, intentional interference with contract, etc."). This is not an exception to the economic loss doctrine, but rather the careful application of its first branch. *See Sunridge Development Corp.*, 2010 UT 6, ¶28 ("First, it bars recovery of economic losses ***in negligence actions*** unless the plaintiff can show physical damage to other property or bodily injury." (emphasis added)).

This first branch of the economic loss rule is not at issue on this appeal. Rather, the certified question Court implicates the second branch of that rule.

The second branch of the economic loss rule applies when, as here, a contract exists between the parties. As already discussed, this second branch declares that "[w]hen a

conflict arises between parties to a contract regarding the subject matter of that contract, the contractual relationship controls, and parties are not permitted to assert actions in tort.'"[8] *Reighard*, 2012 UT 45, ¶21.

Unlike the first branch of the economic loss rule, the second branch is not limited to negligence claims. Rather, its application is determined based on the boundaries of the contact. The doctrine prevents assertion of any tort claim when a contract exists and covers the same subject matter. *See Grynberg v. Questar Pipeline Co.*, 2003 UT 8, ¶44, 70 P.3d 1 ("[W]hen parties' difficulties arise directly from a contractual relationship, the resulting litigation concerning those difficulties is one in contract ***no matter what words the plaintiff may wish to use in describing it.***" (quoting *Snyder v. Lovercheck*, 992 P.2d 1079, 1088 (Wyoming 1999))).

As recognized, "[t]he Utah Supreme Court has never recognized an exception [to this second branch of the economic loss rule] for claims of fraudulent inducement." *Donner v. Nicklaus*, 778 F.3d 857, 875 (10th Cir. 2015). Instead, tort claims in general, including "fraud . . . are not cognizable under Utah law when they are based on the allegations that are the gravamen of the contract claim." *See Wardley Corp. v. Meredith Corp.*, 93 F. App'x 183, 186 (10th Cir. 2004). There is no reason for the Court to now

[8] It would perhaps be easier to understand the economic loss rule if its two branches had developed and always been explained independently. The first branch can be explained as a matter of the proximate causation required by tort law. A third-party's purely economic harms are not reasonably foreseeable to a negligent actor and, therefore, are not recoverable. The second branch easily can be explained as a matter of contract law. A contract allows the parties to define their own relationship and thereby preempt society's default presumptions concerning the nature of their interactions.

change the law and create a new, blanket exception that exempts fraud claims from the second branch of the economic loss rule.

A. Creating an Exception Would Weaken Bedrock Contract Concepts.

The economic loss rule prevents contract parties from "attempt[ing] to circumvent the bargain they agreed upon." *Reighard*, 2012 UT 45, ¶ 20. This concern is illustrated by (but not limited to) an examination of the parol evidence and merger rules.

Under Utah contract law, "[t]he parol evidence rule operates 'to exclude [extrinsic] evidence of contemporaneous conversations, representations, or statements offered for the purpose of adding to the terms of an integrated contract.'" *DCH Holdings, LLC v. Nielsen*, 2009 UT App 269, ¶8, 220 P.3d 178; *see also Tangren Family Trust v. Tangren*, 2008 UT 20, ¶¶11-12, 182 P.3d 326 (same).[9] Likewise, "[n]othing is better settled in the law, where there is a contract in writing, than that all preliminary negotiations are merged into the written contract." *Halloran-Judge Trust Co. v. Heath*, 258 P. 342, 346 (Utah 1927); *accord Verhoef v. Aston*, 740 P.2d 1342 (Utah Ct. App. 1987) ("[A] basic tent of contract law is that prior negotiations and agreements merge into the final written agreement on the subject.").

A party should not be able to circumvent these foundational rules of contract law by asserting a tort claim that depends upon a "conversation[], representation[], or statement[]"

[9] In *Tangren*, the Court suggested that the parol evidence rule applies "in the absence of fraud or other ***invalidating*** causes." *Id.* ¶11 (emphasis added). The Royalty Agreement in this case has not been invalidated. Rather, both parties have sued to enforce that contract. Accordingly, the certified question does not ask whether the economic loss rule applies if the contract is invalid.

that was preceded the final, integrated contract. *See* DCH Holdings, LLC, 2009 UT App 269, ¶8. Yet failure to strictly adhere to the economic loss rule invites that result.[10] Indeed, clever litigants already have tried to circumvent Utah's contract law through tort claims.

For example, *KeyBank National Assoc. v. Sys. West Computer Res., Inc.*, 2011 UT App 441, 265 P.3d 107, addressed an integrated contract governing "KeyBank's one-million-dollar loan to System West." *Id.* ¶2. System West argued that KeyBank had represented that it "would continue to extend the loan's maturity date and would not demand full payment" so long as the interest payments were current. *See id.* ¶17. However, the contract "was fully integrated" and unambiguously declared that the loan "came due July 15, 2008." *Id.* ¶¶15, 2. The court followed basic contract law and refused to "consider parol evidence of the parties' intent that would alter the Integrated Agreement's express terms." *Id.* ¶18. System West predicted this result and therefore sought to obtain a modification of the contract through tort law. Specifically, System West asserted a tort

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[10] One jurist in California lamented the weakening of the parol evidence rule in his state:

> It can be contended that there may be no evil per se in considering testimony about every discussion and conversation prior to and contemporaneous with the signing of a written instrument and that social utility may result in some circumstances. The problem, however, is that which devolves upon members of the bar who are commissioned by clients to prepare a written instrument able to withstand future assaults. Given two experienced businessmen dealing at arm's length, both represented by competent counsel, it has become virtually impossible under recently evolving rules of evidence to draft a written contract that will produce predictable results in court. The written word heretofore deemed immutable, is now at all times subject to alteration by self-serving recitals based upon fading memories of antecedent events. This, I submit is a serious impediment to the certainty required in commercial transactions.

Delta Dynamics, Inc. v. Arioto, 69 Cal. 2d 525, 532 (Cal. 1968) (J. Mosk, Dissenting).

claim for misrepresentation and argued "the parol evidence rule has no bearing on its counterclaim . . . because it is a tort." *Id.* ¶30 (rejecting argument as inadequately briefed).

Likewise, in *Wardley Corp. v. Meredith Corp.*, 93 Fed. Appx. 183 (10th Cir. 2004), the plaintiff's breach of contract claim was rejected because "a party may not vary or modify" the terms of an integrated contract "based on parol evidence." *Wardley Corp.*, 93 Fed. Appx. at 185. The plaintiff nevertheless tried to introduce the same parol evidence by asserting tort claims for "negligent misrepresentation and fraud." *Id.* at 186-87. The effort failed because the Tenth Circuit recognized the tort claims "are not cognizable under Utah law when they are based on the allegations that are the gravamen of the contract claims." *Id.* at 186.

As these examples illustrate, creating a new exception to the second branch of the economic loss rule would substantially weaken important contract bedrocks. "Were we to recognize a cause of action under [tort law] . . . parties could essentially sidestep contractual duties by bringing a cause of action in tort to recover the very benefits they were unable to obtain in contractual negotiations." *SME Industries, Inc. v. Thompson, Ventulett, Stainback & Assoc., Inc.*, 2001 UT 54, ¶44, 28 P.3d 669. To permit tort claims based on alleged oral statements covering the same subject as the contract "would be to cast doubt upon the integrity of all contracts and to leave a party to a solemn agreement at the mercy of the uncertainties of oral testimony given by one who in the subsequent light of events discovers that he made a bad bargain." *E.A. Strout Western Realty Agency, Inc. v. Broderick*, 522 P.2d 144, 145-46 (Utah 1974). "If one in defense to an action on the contract were to be permitted to say that the other falsely represented that something had been included or

excluded therefrom, the writing would be of little value. Every case could present a jury question as to whether the writing correctly expressed the agreement." *Johnson v. Allen*, 158 P.2d 134, 137-38 (Utah 1945).

B. Contract Law Already Provides Adequate Remedies and Protections.

There is no reason to create a blanket exception to the economic loss rule and allow tort claims where contract law already provides adequate remedies and protections.

Utah contract law provides a plethora of available remedies to injured parties. For example, a contract party may seek rescission and restitution. *See, e.g.*, *Polyglycoat Corp. v. Holcomb*, 591 P.2d 449, 451 (Utah 1979) ("[A] party to a contract has a right of rescission and an action for restitution as an alternative to an action for damages where there has been a material breach of the contract by the other party."). A contract party can recover general and consequential damages. *See, e.g.*, *Mahmood v. Ross*, 1999 UT 104, ¶19, 990 P.2d 933 ("Typically, there are two types of damages a non-breaching party can recover in an action for breach of contract: general damages . . . and consequential damages . . . ."). A contract party also can obtain specific performance of the contract. *See, e.g.*, *Eliason v. Watts*, 615 P.2d 427, 427-31 (Utah 1980) (affirming specific performance).

Contract law also contains a number of related doctrines that may apply in the event of intentional misconduct. For example, the doctrine of good faith and fair dealing "requires a party in a contract to perform 'consistent with the agreed common purpose and the justified expectations of the other party.'" *Cheney v. Hinton Burdick Hall & Spilker, PLLC*, 2015 UT App 242, ¶17, 366 P.3d 1220. The doctrine of unconscionability ensures the "prevention of oppression and unfair surprise." *Ryan v. Dan's Food Stores, Inc.*, 972

P.2d 395, 402 (Utah 1998). "Both waiver and estoppel can operate to prevent a party from demanding strict compliance with a contract." *Lone Mountain Production Co. v. Natural Gas Pipeline Co. of Am.*, 710 F. Supp. 305, 310 (D. Utah 1989). And, the requirement that there be a meeting of the minds ensures each party to the contract understood all of "the essential portions of the agreement." *Terry v. Bacon*, 2011 UT App 432, ¶21, 269 P.3d 188. *Cf. Allen v. Prudential Property & Cas. Ins. Co.*, 839 P.2d 798, 805-06 (Utah 1992) (refusing to look outside contract law and declaring "[i]t is not clear why estoppel, waiver, unconscionability, breach of the implied warranty of good faith and fair dealing, and the rule that ambiguous language is to be resolved against the drafter, for example, are insufficient to protect against overreaching insurers when applied on a case-by-case basis").

Utah contract law is sufficient to handle Synergy's claims or any other claims that arise from a contract transaction. There is no need to turn to tort law for the appropriate resolution of a contractual relationship.

C. The Economic Loss Doctrine Applies Equally to and Protects Both Parties.

It is common for both parties in a breach of contract case to believe that the other has acted improperly. Focusing on the contract language narrows the dispute and provides the certainty for which both parties bargained. Indeed, this case is a prime example of how both parties benefit from the application of the economic loss doctrine.

When HealthBanc originally filed this case, it "alleged that Synergy had breached the contract" by "failing to pay royalties." *HealthBanc Int'l, LLC v. Synergy Worldwide,*

Inc., 208 F. Supp. 3d 1193, 1195 (D. Utah 2016).[11] "HealthBanc also asserted in its third cause of action that Synergy . . . committed constructive fraud by failing to disclose the deficient royalty payments." *Id.* Synergy "moved to dismiss this [fraud] cause of action, arguing that it is barred as a matter of law under Utah's economic loss rule." *Id.* at 1196. Judge Parrish protected Synergy's contract rights and expectations by dismissing HealthBanc's fraud claim as "barred by the economic loss doctrine." *Id.* at 1199-1200.[12]

As the history of this case suitably illustrates, the economic loss rule is not some technical windfall to a particular party. Rather, its applications protect all of the parties to a contract by directing the parties to the terms of their agreement.

[11] HealthBanc was represented by different counsel at that time.

[12] It is unclear why the trial court did not certify the current question at that time. Instead, the court dismissed HealthBanc's fraud claim based on the economic loss rule. HealthBanc then moved for summary judgment on Synergy's fraud claim by arguing it was barred by the statute of limitations. Although that motion did not argue the economic loss rule, the trial responded by certifying the present question. In other words, the trial court dismissed HealthBanc's claim when the economic loss rule squarely was presented, only to subsequently certify the issue when the question was not asked. Equally curious, the federal trial court recognized that the Tenth Circuit had answered this question under Utah law, but ignored the *stare decisis* impact of that decision. [*See* Order of Certification (R.516) at 3 ("[Tenth Circuit] recently held that the economic loss rule applies to fraudulent inducement claims under Utah law.")]. *Cf. Wankier v. Crown Equip. Corp.*, 353 F.3d 862, 867 (10th Cir. 2003) ("Following the doctrine of stare decisis, one panel of this court must follow a prior panel's interpretation of state law . . . .").

CONCLUSION

Synergy's fraud claim is based on an alleged breach of a warranty provision that exists in the parties' written, integrated contract. "Synergy has simply recast what would traditionally be a . . . breach of warranty claim into what it calls a 'common law' tort-based . . . claim to evade the preclusive effect of the 'economic loss' doctrine. Such effort fails. Contract lives!" *Apollo Grp., Inc. v. Avnet, Inc.*, 58 F.3d 477, 481 (9th Cir. 1995).

This Court should reaffirm that the economic loss rule bars all tort claims that overlap with the subject matter of the parties' contract.

Dated this 19th day of January, 2018

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CERTIFICATE OF COMPLIANCE

I hereby certify that:

1- This brief complies with the type-volume limitation of Utah R. App. P. 24 because the brief contains 6,488 words, excluding the parts of the brief exempted by Utah R. App. P. 24(g)(2).

2- This brief complies with Utah R. App. P. 21, governing public and private records.

3- This brief complies with the typeface requirements of Utah R. App. P. 27(b) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 13-point Times New Roman.

Dated this 19th day of January, 2018

/s/ Mitchell A. Stephens

CERTIFICATE OF SERVICE

This is to certify that on the 19th day of January, 2018, I caused two true and correct copies of the Brief of Plaintiff and Counterclaim Defendants to be served on the following via hand-delivery:

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