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Recent Developments: *Ellerin v. Fairfax Savings, F.S.B.*: Actual Knowledge of a Misrepresentation, Coupled with an Intent to Deceive Thereby, Satisfies the Actual Malice Requirement for an Award of Punitive Damages in a Tort Action of Fraud

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Ellerin v. Fairfax Savings, F.S.B.:

**ACTUAL
KNOWLEDGE OF A
MISREPRESENTATION,
COUPLED
WITH AN INTENT
TO DECEIVE
THEREBY, SATISFIES
THE ACTUAL
MALICE
REQUIREMENT
FOR AN AWARD
OF PUNITIVE
DAMAGES IN
A TORT ACTION
OF FRAUD.**

In an opinion that gave an extensive review of fraud and the concept of punitive damages, the Court of Appeals of Maryland determined the appropriate standard for an award of punitive damages in a tort action of fraud. In *Ellerin v. Fairfax Savings, F.S.B.*, 337 Md. 216, 652 A.2d 1117 (1995), the court of appeals held that a person's actual knowledge of falsity, coupled with an intent to deceive by way of the falsehood, established the actual malice required for the availability of punitive damages in an action of fraud.

Charles Ellerin and Louis Seidel ("Ellerin") financed a commercial real estate development through Fairfax Savings, F.S.B. ("Fairfax"). In order to secure its loan, Fairfax required Ellerin to personally guarantee the project. It was undisputed that the final guarantees signed at the settlement were different from earlier drafts approved by Ellerin. Although Ellerin would not have been liable under the approved drafts, he was liable, after subsequent default, under the guarantees signed at settlement. Fairfax's attorneys insisted that the addition of extended liability, to the final guarantees, was unintentional.

Fairfax filed suit in the Circuit Court for Baltimore County for repayment of the loan. Ellerin counterclaimed, asserting that Fairfax had fraudulently changed the guarantees. The jury found Fairfax's actions fraudulent. However, the

jury also found that Ellerin ratified the fraud by continued performance. As such, summary judgment was granted in favor of Fairfax. The court of special appeals reversed and remanded, holding that Ellerin's continued performance did not preclude him from damages based on fraud. The second trial ended in a hung jury. At the third trial, the only inquiry concerning fraud was Ellerin's knowledge, at the signing, of changes made to the guarantees. The trial court held that, as a matter of law, Ellerin had ratified the guarantees and was liable.

In the damages phase, undertaken to ascertain Fairfax's liability in the fraud action, the jury awarded both compensatory and punitive damages. The trial court denied Fairfax's request to instruct the jury with respect to the malice necessary for punitive damages, since, in the court's view, actual malice was inherent in the elements of fraud. Fairfax appealed to the Court of Special Appeals of Maryland which affirmed the compensatory damages, but vacated the punitive damages award. The intermediate appellate court held that the jury should have been instructed as to the element of malice necessary to support an award of punitive damages, and ordered a new trial. Fairfax's petition for a writ of certiorari, concerning its liability for compensatory damages, was denied by the court of appeals. Ellerin's petition for a writ of certiorari, challenging the new trial on pu-

nitive damages, was granted.

Beginning its analysis, the Court of Appeals of Maryland reviewed the justification for the imposition of punitive damages, that is, to “punish and deter” the actions of a wrongdoer. The court highlighted the character of the defendant’s conduct as the determining factor for the imposition of punitive damages. Citing the standard for punitive damages in non-intentional tort cases, the court held that the conduct of the defendant will be deemed sufficiently heinous when “characterized by evil motive, intent to injure, ill will, or fraud, *i.e.* ‘actual malice.’” *Ellerin*, 337 Md. at 229, 652 A.2d at 1123 (quoting *Owens-Illinois v. Zenobia*, 325 Md. 420, 460, 601 A.2d 633, 652 (1992)).

Analyzing the tort of fraud, as related to the punitive damages requirement of actual malice, the court emphasized the elements of intent and knowledge. In an action for fraud, the defendant must have knowledge of the falsity and a “deliberate intent to deceive” based on the falsehood. *Id.* at 230, 652 A.2d at 1124. The knowledge element of fraud, that the falsehood was actually known or that the defendant offered the misrepresentation with reckless indifference as to its truth, was clarified by the court. *Id.* at 232, 652 A.2d at 1124. As the court explained, a defendant will be “liable in a tort action of fraud only if he knows the misrepresentation was false or was recklessly in-

different in the sense that he knows he lacks knowledge as to its truth or falsity.” *Id.* at 232, 652 A.2d at 1125.

Considering that punitive damages must be based on a defendant’s conscious wrongdoing, the court qualified the knowledge element of fraud with respect to punitive damages. The court held that although the defendant’s reckless disregard of the truth or falsity of a representation satisfies the knowledge element of fraud, it does not meet the *mens rea* standard of actual knowledge required for an award of punitive damages. *Id.* at 235, 652 A.2d at 1126. However, the court held that fraud, committed by a defendant who knows his representation is false, equates to the “deliberate wrongdoing and evil motive” that justifies the award of punitive damages. *Id.* Therefore, the basis for punitive damages, in an action of fraud, is actual knowledge of the falsity of the representation, coupled with an intent to use such a falsehood to deceive. *Id.* at 240, 652 A.2d at 1129. Such a finding of actual knowledge, as opposed to reckless indifference, satisfies the actual malice requirement for an award of punitive damages. *Id.*

The court vacated the award of punitive damages and ordered a new trial concerning such damages. *Id.* at 241, 652 A.2d at 1129. The court required that the jury be instructed as to the elements of fraud, and that the trial court note the actual knowledge and reckless

indifference distinction central to the *Ellerin* decision. *Id.*

In dicta, the court also provided the trial court some “guidance” as to the issue of excessive punitive damages. The court stated that, upon request, the jury should be instructed that the amount of punitive damages should not be disproportionate to the wrongfulness of the conduct or the ability of the defendant to pay. *Id.* at 242, 652 A.2d at 1130. In a final footnote, the court analogized the amount of punitive damages to maximum criminal fines, stating that the trial court “may consider the legislative policy reflected” in such statutes. *Id.* at 242 n.13, 652 A.2d at 1130.

Although he concurred with the majority’s opinion, regarding the necessity of actual malice in a fraud action, Judge Bell dissented as to the distinction between actual knowledge and reckless indifference. *Id.* at 244, 652 A.2d at 1130 (Bell, J., dissenting). He reasoned that the requisite mental state necessary for punitive damages is inherent in the elements of fraud, and, as such, the distinction outlined by the court is unnecessary. *Id.* Judge Bell also questioned the propriety of the majority’s analogy, to criminal fines, as adding unnecessary confusion to the jury instructions. *Id.* at 247, 652 A.2d at 1132.

In drawing a distinction between the two knowledge elements of fraud, and the requisite *mens rea* for an award of

punitive damages, *Ellerin v. Fairfax*, clarifies the relationship between two seemingly settled areas of law. The law, its elements, and the standards by which it is measured, are in constant need of refinement and interpretation. However, whereas the standard for punitive damages in a fraud action is more focused, the value

of the court's dicta, on excessive punitive damages, is unknown. The lack of an authoritative judicial decision may further confuse the issue. Adding another variable to the equation does not solve the problem. However, consideration of legislative policy may lay the foundation for an effective judicial tool regarding the reasonable-

ness of punitive damages awards.

Nevertheless, given the precarious political climate, at the state and national level, concerning tort reform and punitive damages, it is encouraging that the issue of excessive punitive damages has entered the judicial discussion.

- Terrence J. Daly

Jessica G. v. Hector M.:

**MOTHER'S
UNSUCCESSFUL
PATERNITY ACTION
DOES NOT
BAR CHILD'S
SUBSEQUENT
PATERNITY ACTION.**

In a case of first impression, the Court of Appeals of Maryland held that a paternity action brought by a mother, then dismissed with prejudice, does not necessarily bar a subsequent paternity action brought by the child. Of even more importance, the court's ruling in *Jessica G. v. Hector M.*, 337 Md. 388, 653 A.2d 922 (1995) broadly construed Family Law Code, section 5-1038(b), to allow the modification or setting aside of all paternity orders except declarations of paternity. Thus, even an order terminating litigation, such as a dismissal with prejudice, can be set aside and the paternity issue relitigated by the child's subsequent paternity action.

In March 1985, Joyce G. and Hector M. had an intimate relationship. In December of that same year, Joyce gave birth to Jessica G. Soon after Jessica's birth, Joyce filed a paternity action against Hector in the Circuit Court for Harford County. Blood tests of the three parties indicated that there was a 99.97% chance that

Hector was Jessica's father. Nonetheless, Hector refused to admit paternity. After two years of prolonged discovery, Joyce asked to stop the paternity action. A consent order to dismiss the action with prejudice was drafted and signed by all parties but Joyce. When the Assistant State's Attorney explained the meaning of with prejudice, Joyce refused to sign the order. However, in March 1988, the State's Attorney docketed the consent order.

Joyce tried repeatedly to continue the paternity action. She filed another paternity suit in the Family Court of New York. The New York court dismissed the action, relying solely on the 1988 Harford County dismissal with prejudice. While Joyce was pursuing various avenues of appeal, Jessica filed a paternity action against Hector in the Circuit Court for Harford County.

Hector responded by filing a motion to dismiss Jessica's action based on the doctrine of res judicata. The circuit court found that Joyce was rep-