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Imposing Penal Sanctions for Breach of Home Improvement Contract, in the Absence of Fraud, Is Involuntary Servitude

Stephen McKenna

Tax Opinions
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also sought the interest they were required to pay on the back taxes. The two actions were combined for consideration by the Supreme Court, New York County.

Supreme Court, New York County

The lower court dismissed the claims of Alpert and Wolfman for back taxes but allowed recovery of the interest paid on the deficient taxes. Further, the court allowed the investors to amend their complaints to assert an additional claim of breach of fiduciary duty but denied them leave to amend their complaints to include an additional cause of action in fraud.

Supreme Court, Appellate Division

On appeal, the court first rejected the damage claims of Alpert and Wolfman for back taxes. The court stated that the recovery of damages for fraud is limited to that which is necessary to restore a party to the position occupied before commission of the fraud. The court noted that the victim of fraud may not recover the benefit of an alternative agreement overlooked in favor of the fraudulent one. Therefore, the court denied Alpert and Wolfson recovery of back taxes in this case because such recovery would place the investors in a far better position than had they never invested in Logan.

Additionally, the court denied Alpert and Wolfman leave to amend their complaints to assert an additional cause of action in fraud against the Esanu firm which had structured Logan. The original complaint alleged only that the Esanu firm's opinion was knowingly false, while the proposed amended complaint alleged that the facts in the Logan offering memorandum were false. The court denied leave to amend because the original complaint did not give the proper notice necessary to enable the Esanu firm to prepare a defense since the complaint did not sufficiently state the circumstances surrounding the amended fraud claim. In addition, such an amendment would require supplemental discovery that would result in prejudicial delay of the case. Therefore, the court denied leave to amend to include a second cause of action in fraud.

As to the issue of recovery of interest paid on the deficient taxes, the court held that recovery of interest must be denied. The court cited a case in which the United States Court of Appeals for the Second Circuit found that a defrauded investor in a coal mine tax shelter was not allowed to recover interest paid to the I.R.S. upon disallowance of tax deductions. That court reasoned that such interest did not constitute damages suffered by the investor but rather was a payment to the I.R.S. for the investor's use of the money during the period when he was not entitled to it. The New York court adopted the reasoning of the Second Circuit. The court also reasoned that it was more equitable to bar recovery of interest rather than to allow the investors the windfall of both having used the tax monies for seven years and recovering all interest thereon.

Lastly, the court denied leave to amend the complaints to include assertions of breach of fiduciary duty because there was no support for the conclusion that such a fiduciary relationship existed between Alpert and Wolfman and the Esanu firm and Shea Gould in the absence of a contractual relationship between the parties. The court used a three-prong test to determine whether professionals, such as the defendant law firms, would be liable for negligence for inaccurate reports. Under the test, (1) the professional must have been aware that the reports were to be used for a particular purpose, (2) there must have been a known party who intended to rely on the reports for furtherance of a purpose, and (3) there must have been some conduct on the part of the professional evidencing his knowledge of the other party's reliance on the report.

In this case, the court held that Alpert and Wolfman failed to satisfy the test because there was no evidence that the Esanu firm and Shea Gould were aware that the potential investors would rely on their tax opinion letters or that Alpert and Wolfson, in particular would. The class of potential investors was neither fixed nor identifiable.

Astrid E. Ellis

Imposing Penal Sanctions For Breach Of Home Improvement Contract, In The Absence of Fraud, Is Involuntary Servitude

In ***State v. Brownson,*** 459 N.W.2d 877 (Wis. App. 1990), the Court of Appeals of Wisconsin held that the state, absent some indicia of fraud or misrepresentation, may not impose penal sanctions for breach of a labor contract. The court held that doing so constitutes the type of involuntary servitude prohibited by the United States and Wisconsin Constitutions. The court also held that challenges to a statute based upon the "overbreadth doctrine" must be linked to a first amendment claim, and that the state, in criminal proceedings, need not prove intent unless it is a statutorily required element of the crime alleged.

Background

James Brown ("Brown") asked William Brownson ("Brownson") to build a garage. Brownson was the general manager of Professional Workers Construction ("PWC"). In a written home improvement contract, the two men agreed that Brownson, through PWC, would build the garage for $5,525.00. Brown made a down payment of twenty percent of the garage's total cost and additional payments of $3,315.00 and $826.80. Brownson never completed the garage. One unpaid materialman filed notice of intent to file a lien.

In May 1990, the Circuit Court of Outagamie County, Wisconsin convicted Brownson of violating three provisions of the Wisconsin Administrative Code: (1) § Ag 110.05(2)(d), failure to include the

start and finish dates in a written home improvement contract; (2) § Ag 110.02(6)(m), failure to furnish proper lien waivers; and (3) § Ag 110.05(9), failure to comply with the terms of a home improvement contract. The court assessed separate criminal penalties against Brownson for each offense. Brownson appealed.

The Parties' Arguments on Appeal

Brownson argued that imposing criminal penalties against him for the breach of a labor contract, in the absence of evidence of fraudulent intent, constituted involuntary servitude in violation of the Wisconsin and United States Constitutions. He also argued that § Ag 110's definition of "seller" was vague and overly broad and was therefore unconstitutional. Finally, Brownson alleged a violation of his due process rights based upon the fact that the state was not required to prove the element of intent in his criminal prosecution. He argued that wholly passive activity, without any proof of intent, could not form the basis of a crime.

The State, on the other hand, argued that finding for Brownson would leave the public unprotected from the unscrupulous practices employed by some builders. The State noted that statutes criminalizing the breach of a labor contract, previously struck down by the United States Supreme Court, were statutes whose real purpose was to force poor southern black workers into peonage. The State argued that § Ag 110.05(9) was immune to constitutional challenge absent evidence of similar malicious intent on the part of the Wisconsin legislature.

The Court of Appeals' Decision

The court agreed with Brownson that imposing penal sanctions for the breach of a labor contract, in the absence of any indicia of fraud or misrepresentation, constituted involuntary servitude in violation of the Wisconsin and United States Constitutions. According to the court, the thirteenth amendment prohibited involuntary servitude enforced by the use or threatened use of physical or legal coercion; the threat of a criminal penalty for breach of a labor contract amounted to just such coercion. The United States and Wisconsin Constitutions permitted involuntary servitude only as a punishment for a crime or in certain "exceptional" cases such as those relating to compelled jury or military duty or those relating to parent-child relationships. Because Brownson's case did not fall within any of the "exceptional" categories, the court vacated Brownson's conviction for failure to comply with the terms of a home improvement contract under § Ag 110.05(9).

In so holding, the Wisconsin court accepted the reasoning of an earlier decision in the New York Court of Appeals which had, after interpreting previous United States Supreme Court decisions, struck down a statute imposing penal sanctions for the breach of a labor contract. In *People v. Lavender,* 48 N.Y.2d 334, 422 N.Y.S.2d 924, 398 N.E.2d 530 (1979), the court found that the state has the right to punish fraud. However, because the fraud was perpetrated by means of a labor contract, it was a unique kind of fraud. This special nature required conformity with the statutory and constitutional provisions which prohibited the state from making failure to work in discharge of a debt any part of a crime. The Wisconsin court of appeals agreed that the state may not enforce involuntary servitude, directly or indirectly, even if it arose out of a contract voluntarily entered. The state could only subject Brownson to a judgment for breach; it could not hold Brownson criminally liable for his breach.

The overbreadth challenge to § Ag 110's definition of a "seller" failed because the court found that Wisconsin and federal constitutional law required that overbreadth challenges be linked to first amendment claims. Brownson failed to raise a first amendment issue. Therefore, Brownson could not use the overbreadth doctrine. The court stated that Brownson could not rely upon purely hypothetical situations to overturn his conviction.

Finally, Brownson's due process challenge failed. The court found that intent is not an element of a crime unless required by statute. In this case, neither § Ag 110.05(2)(d) nor § Ag 110.02(6)(m) included any intent requirement and thus none need be proved. The court held that Brownson was a "seller" within the meaning of the statute, that Wisconsin public policy mandated holding sellers to minimum standards of behavior, and that these standards must be backed by criminal penalties in order to protect the innocent public. Also, Brownson admitted that his conduct was not wholly passive and so involved some degree of intent. Therefore, Brownson's conviction without proof of intent did not violate his due process rights. Accordingly, the court upheld Brownson's convictions under § Ag 110.05(2)(d) for failure to include start and finish dates in a written home improvement contract and under § Ag 110.02(6)(m) for failure to furnish proper lien waivers.

The Court's Disposition of the Case

The court of appeals remanded the case with instructions that Brownson's $70.00 fine and nine-month jail sentence for breach of the labor contract should be vacated. According to the court, to do otherwise would amount to the enforcement of involuntary servitude in violation of the thirteenth amendment. The court also instructed that the trial court's order of restitution and the remainder of Brownson's sentence should not be disturbed.

Stephen McKenna

Consumer News: Deceptive Automobile Avertisements

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economy flattens, attracting the consumer's dollar becomes more important, and some dealers find themselves crossing the line to attract customers," said Sally Saltzberg, deputy chief of the Illinois attorney general's consumer division.

The FTC recently sent a letter to automakers and their advertising agencies warning that big fines and other penalties would be imposed if car advertising included misleading claims or deceptive demonstrations. The notice may show a shift in policy at the FTC regarding its posture toward advertising agencies. During the 1980s, the FTC pursued enforcement actions only against manufacturers.

The letter follows an admission in late 1990 by the Swedish manufacturer Volvo that it faked a demonstration involving one of its cars. The Volvo ad showed the giant-wheeled truck "Bear Foot" crushing a line of cars leaving a Volvo station wagon unscathed. But residents of Austin, Texas, who played extras in the commercial, were suspicious, and they called the Texas attorney general's office. After an investigation, Texas Attorney General Jim Mattox charged that the ads were misleading in several ways, including that the Volvo had been structurally reinforced with steel or lumber. "The car-crushing competition was a hoax and a sham," Mattox alleged in a complaint filed against Volvo.

In a settlement with the attorney general, Volvo agreed to pull the advertisements and publicly announce the ads were phony, but the company acknowledged no wrongdoing. "The feeling was that the ad was done tongue-in-cheek so that people might not take it seriously," said William Hoover, senior vice president of marketing for Volvo. "It was a dumb decision."

According to Jerry Cizek, executive director of the Chicago Automobile Trade Association, which represents over 700 new-car retailers, dealers groups also are working to halt deceptive ads. "We recognize there's a problem, and we're committed to correcting it as an association," Cizek said. "We don't want a few dealers spoiling it for the rest." Cizek said he is working to stop "asterisk" ads which often tout an unrealistically low price for a car which may be doubled by add-on charges listed in the fine print.

Postal Rate Increases Limit Junkmail

While consumers may cheer an indirect benefit of the recent postal rate increase in the form of less "junk mail," magazine publishers and direct-mail advertisers are looking for ways to save their industry. The rise in rates has hit the industry hard with a twenty-two percent increase for second-class mail (magazines and newspapers) and a twenty-five to forty-one percent increase for third-class mail (catalogues, commercial, nonprofit, and magazine subscription solicitation). "Coupled with the 18 percent increase that we had in 1988, our costs have gone up 40 percent in a three-year period," said D. Claeys Bahrenburg, president and chief executive of Hearst Magazines. "We are basically appalled by it."

Publishers and direct-marketers are considering a number of alternatives to deal with the rate increase. Two direct-mail advocacy groups, the Direct Marketing Association ("DMA") and the Third Class Mail Association ("TCMA") are considering challenging the new rates in court. "If everything ultimately is accepted the way it is now, there may be lawsuits by one or more parties, including TCMA," said Gene Del Polito, executive director of TCMA.

Direct-marketers and publishers also plan to focus their solicitation efforts by targeting interested consumers. According to George Wiedmann, president of Grey Direct, the direct-marketing division of Grey Advertising, the rate increase "is going to force direct-marketers to rediscover mass media." Cable television, which is already set to reach specific consumer groups, is the most likely medium. Through the use of toll-free telephone numbers to get the names and numbers of prospective customers, direct marketers will mail advertising and information only to those who are most interested in their products.

Publishers and direct-marketers also are considering alternative delivery systems to get their products to consumers. One such private enterprise, Alternate Postal Delivery of Grand Rapids, Michigan, plans to expand into ninety-five markets in four years. Phillip Miller, president of the company, estimated that publishers could save fifteen to eighteen percent in delivery costs. According to Norman Rosen, president of Time Warner's alternative delivery division, Publishers Express, "Alternative delivery makes economic sense... mailers are so upset by the new rates that those who were sitting on the fence will now get involved in alternative delivery."

ANNOUNCEMENT

New Committee To Focus On Consumer Protection

The Section of Antitrust Law of the American Bar Association recently created a Consumer Protection Committee to focus on consumer protection developments and enforcement initiatives. State and private enforcement activities and counseling issues involving consumer fraud, deceptive advertising and marketing will be the principal interests of the Committee. The Committee's membership includes state and federal agency lawyers, corporate counsel, and private practitioners involved in advertising and consumer protection matters.

If you wish to join the Committee or if you want further information about its activities, contact the Committee Chair:

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