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Does an Individual Lacking Contractual Privity Have Standing Under § 1981 to Bring a Claim for Racial Discrimination?

by Ralph C. Anzivino

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ISSUE
In the absence of a contractual relationship, are allegations of personal injury through racial discrimination sufficient to confer standing under 42 U.S.C. § 1981?

FACTS
Petitioners Domino’s Pizza, LLC, and Domino’s Pizza, Inc., had four contracts with JWM Investments, Inc., under which JWM agreed to build restaurants and lease them to Domino’s. Respondent John McDonald is the president and sole shareholder of JWM. The first restaurant was completed within the timeframe specified in the contracts. The second encountered a variety of problems, including difficulties with city zoning. These problems led to delays in construction, and the relationship between JWM and Domino’s soured. The contracts between JWM and Domino’s stated that Domino’s would execute “estoppel certificates” for JWM if necessary for financing and/or sale purposes. An estoppel certificate is a tenant’s written description of its interest in property, which enables prospective mortgagees or pur-
Domino's and JWM deteriorated until Domino's ultimately terminated the contracts. Although Domino's adamantly denies the charge, McDonald alleges that Domino's decision to terminate its contract with JWM was motivated by racial discrimination because McDonald is African American. He also alleges that JWM had various financial difficulties after the termination of the JWM-Domino's contracts, leading to JWM's eventual bankruptcy.

JWM brought a claim against Domino's arising from this contract dispute during JWM's Chapter 11 bankruptcy proceedings. Domino's settled that claim for $45,000 in exchange for a complete release from JWM, and the bankruptcy court accepted the settlement. After settling the claim on behalf of JWM, McDonald filed this lawsuit against Domino's in his individual capacity. His complaint alleges a violation of 42 U.S.C. § 1981, which protects the right “to make and enforce contracts” free from discrimination. The complaint acknowledges that the only contracts at issue were between JWM and Domino's. Domino's moved to dismiss the complaint under Federal Rule of Civil Procedure 12(b)(6) on the ground that JWM lacked statutory standing to sue. Domino's argued that 42 U.S.C. § 1981 protects the contractual relationship and, since McDonald was not a party to the contracts at issue, his allegations of injury were not covered by the statute. The district court agreed. The district court reasoned that § 1981 protects the contractual relationship itself and therefore limits the class of persons who may sue under § 1981 to persons in the contractual relationship. The court further held that while JWM might have a claim under § 1981, a president or sole shareholder may not step into the shoes of the corporation and assert that claim personal- ly. The court granted the motion and dismissed the complaint with prejudice.

On appeal, the Ninth Circuit reversed in a summary order. McDonald v. Domino's Pizza, 2004 U.S. App. Lexis 12176. The court ruled that it was bound to follow a prior Ninth Circuit case, Gomez v. Alexian Brothers Hospital, 698 F.2d 1019 (9th Cir. 1983). In Gomez, a Hispanic physician who practiced medicine as an employee of a professional corporation brought an individual suit when the defendant hospital rejected the corporation's contract to operate its emergency room for allegedly racial reasons. Analyzing the physician's claim under Title VII, the Ninth Circuit ruled that Gomez had alleged sufficient injury because he had alleged injuries that were distinct from that of the corporation, including loss of employment, and humiliation and embarrassment. The court noted that the same discriminating conduct can result in both corporate and individual injuries. Applying Gomez, the Ninth Circuit held that, although McDonald was not formally a party to the contract, he may nonetheless sue under § 1981 insofar as he seeks recovery for individual injuries separate and distinct from contract damages suffered by JWM Investments, Inc. The Supreme Court granted certiorari on April 25, 2005.

**CASE ANALYSIS**

Petitioner Domino's asserts that a discrete individual injury does not create statutory standing or a federal cause of action. The question of standing is whether the litigant is entitled to have the court decide the merits of the dispute or of particular issues. It involves both constitutional limitations on federal-court jurisdiction and statutory limitations on its exercise. The constitutional limits on standing flow from Article III's case or controversy requirement. Article III standing requires that (1) the plaintiff have suffered an injury in fact that is both concrete and particularized and actual or imminent; (2) the injury be fairly traceable to the acts of the defendant; and (3) it is likely, as opposed to conjectural, that the injury will be resolved by a favorable decision. If a plaintiff does not satisfy that test, then Congress cannot grant that party any federal cause of action because deciding the case would force the federal courts to exceed their constitutional power. It is undisputed that McDonald could have standing under Article III. Accepting the respondent's allegations as true, the respondent is claiming concrete injuries that were allegedly caused by Domino's termination of the JWM contracts, and those injuries would be redressed by the monetary damages he seeks. But the presence of Article III standing establishes only that Congress could grant McDonald a right to judicial relief in these circumstances. It does not establish that such relief is, in fact, available. A plaintiff suing under a federal statute must also demonstrate that the statute grants statutory standing. That is a question of statutory interpretation.

The “statutory standing” analysis ultimately reduces to whether the statutory provision on which the claim rests properly can be understood as granting persons in the respondent's position a right to judicial relief. The Supreme Court has recognized two presumptions about when Congress intends to grant statutory standing to sue. First, there is a presumption that the plaintiff generally must assert his own legal rights and interests and cannot rest his claim to relief on the legal rights or interests of third parties. Second, there is a presumption that a plaintiff will not have stand-
Petitioner Domino's maintains that persons with standing to sue under § 1981 make clear that the only persons with standing to sue under § 1981 are those who have actually suffered some injury to that right. The right to "make and enforce contracts" is defined to include the making, performance, modification, and termination of contracts and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship. 42 U.S.C. § 1981(b). The plain language makes clear that the statute grants to every person the right to be free from racial discrimination in their own actual or prospective contractual relationships. The statute by its terms only provides redress for the discriminatory impairment of the rights protected by this section. 42 U.S.C. § 1981(c). It does not grant a cause of action for all injuries caused by discrimination in the contractual relationship of others.

The legislative history to § 1981 clearly indicates that Congress intended to protect a limited category of rights. The language of the statute traces its origin to § 1 of the Civil Rights Act of 1866, which was enacted shortly after the ratification of the Thirteenth Amendment. The language of the 1866 act was re-codified in virtually identical form as part of the Enforcement Act of 1870 and is now 42 U.S.C. § 1981(a).

Notably, Congress removed a broad opening declaration to the 1866 act that stated that "there shall be no discrimination in civil rights or immunities among citizens on account of race, color, or previous condition of slavery." Out of concern that this language could be interpreted as encompassing a too-broad spectrum of rights, the language was deleted. The removal of that passage sharply undercuts the view that the 1866 act reflects broader concerns than the specific rights identified in its text.

Several decades ago, the Supreme Court recognized that § 1981 applies to private discrimination as well as to state action. But it has nonetheless consistently described § 1981 as limited to interference (public or private) with the specific right to "make and enforce contracts." And in every case in which this Court has examined the scope of § 1981, the plaintiff was in a contractual relationship and alleged a violation of a right to make or enforce a contract.

Section 1981 does not grant third-party standing to persons whose own right to "make and enforce contracts" has not been violated. It is well settled that § 1981 protects only an individual right to "make and enforce contracts" free from racial discrimination. The "zone of interests" protected by § 1981 is that right, nothing more and nothing less. Nothing in the statute suggests any intent by Congress to abrogate the ordinary standing rules and permit suit by persons whose own right to "make and enforce contracts" has not been violated, merely because they have suffered some discrete injury traceable to the violation of someone else's right under § 1981. Section 1981 does not contain any provision comparable to other statutes that would authorize suit by "any person" harmed by a violation of its provisions. It grants a set of specific, personal rights and grants statutory standing only to persons who have suffered an injury to those rights.

McDonald has suffered no injury to his personal right to "make and enforce contracts" free from racial discrimination, because he has not alleged any contract to which he was personally a party or to which he hoped to be a party. The only contracts at issue in this case are between two corporations, JWM and Domino's. McDonald has not alleged the existence of any other contract that might provide the grounds for a cause of action under § 1981. All rights and obligations under these
contracts belong to JWM and not to McDonald. If JWM had breached the contracts, McDonald could not be sued for breach. Also, the allegations that Domino’s breached those contracts were properly brought (and settled) by JWM. A violation of JWM’s right to “make and enforce” these contracts would not, even if proven, establish any injury to McDonald personally that is cognizable under § 1981.

Petitioner Domino’s opines that allowing McDonald to sue would upset the balance of the civil rights laws. The fact that McDonald has no cause of action under § 1981 for his individual injuries does not suggest any gap in the coverage of the nation’s civil rights laws. It is entirely consistent with the comprehensive statutory regime Congress has enacted to combat racial discrimination and with well-understood state common-law principles. Permitting McDonald’s claim to proceed would have far-reaching and disruptive consequences. The law simply does not create a remedy for every harm. The general rule is that there is no cause of action to recover collateral, derivative injuries suffered by persons other than the person whose statutory rights were actually violated. And, when the injury in question is pain and suffering, emotional distress, and humiliation, the law has always imposed strict limitations on recovery. Indeed, a claim by an affiliate of a contracting party for emotional distress caused by a breach of contract is a complete stranger to the law. Further, emotional distress is not generally compensable under contract law in any event. Emotional distress damages, however, can be recovered in tort, but generally only when incident to an actual physical injury. Recovery for purely emotional injuries under the tort of intentional infliction of emotional distress is permitted only when the emotional injury is severe and the defendant’s conduct is both intentional and outrageous. Federal civil rights laws also impose strict limitations on relief for purely emotional distress. Under Title VII an employee has no redress for emotional injuries caused by racially offensive statements unless those statements are so severely or pervasively abusive as to create a hostile work environment. The alleged comment that McDonald claims caused him to experience emotional distress simply does not rise to that level as a matter of law. A section 1981 cause of action in these circumstances would, therefore, be inconsistent with the background law that governs comparable claims in other contexts.

Allowing anyone collaterally injured by an alleged violation of § 1981 to sue under that statute would also radically expand the class of plaintiffs that can sue for discrimination under federal law. Although the unique circumstances of this case allow McDonald to claim that he was the direct target of the alleged discrimination, his theory of recovery cannot be limited. The class of potential plaintiffs is essentially limitless. The termination of any contractual relationship will have effects that ripple outward through the economy. When a general contractor loses a contract, that loss may also injure his wife and children, his employees, his subcontractors and their families and employees, the lumber supplier that would have sold to the subcontractor, the lumber supplier’s own timber supplier, and so on forever. The potential injuries extend even beyond persons in the direct chain of economic consequences. A bystander could suffer emotional distress injuries of the sort alleged by McDonald. A right to be free from all collateral consequences of racial discrimination in the private contracting behavior of others, anywhere in our vast economy, would therefore be an extremely radical innovation.

In summary, the petitioner contends that that if there was any cognizable injury to the right “to make and enforce contracts” flowing from the termination of the JWM-Domino’s contracts, that injury was suffered by JWM, not McDonald. JWM brought a breach of contract claim against Domino’s and settled it. If JWM had wanted to join a claim under § 1981 to that breach of contract claim, it could have done so. And, if McDonald had wished to enter into a personal contractual relationship with Domino’s himself, he possibly could have done that as well. What he cannot do is use the corporate form to intentionally distance himself from any individual contractual relationship with Domino’s, and then turn around and sue for injury to that contractual relationship in his personal capacity. McDonald himself has not suffered any injury to the specific interests protected by § 1981 and, therefore, cannot bring suit under that statute.

Respondent McDonald maintains, however, that § 1981 protects the actual targets of contract-related discrimination regardless of whether they contract through formal intermediaries. Section 1981 provides that all persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts. In construing § 1981 and the parallel provision of 42 U.S.C. § 1982, which originated in the same sentence of the Civil Rights Act of 1866, the Supreme Court extended its protections to cover intentional racial discrimination to two classes of individuals. First, sections 1981 and 1982 protect targets of discrimination when they are
actual or would-be contract signatories or property owners. Second, sections 1981 and 1982 protect the actual targets of discrimination when they are conducting their activities through an actual or would-be signatory or owner. As an African American entrepreneur conducting his business through a wholly owned corporation, respondent falls squarely within this well-recognized second category.

Respondent argues that the most natural reading of the plain language of § 1981 protects the contracting behavior of actual targets of discrimination regardless of whether they are formal signatories. For example, there is no question that Domino’s would be liable to McDonald if he had operated his business as a sole proprietorship. The question then is whether McDonald lost the protection of § 1981 when he organized his business as a corporation instead. Nothing in the text of § 1981 supports Domino’s contention that actual targets of discrimination are somehow stripped of protection when they do business through a corporation. To the contrary, when a minority entrepreneur like McDonald does business through a corporation, the terms of § 1981 protect both the actions taken by the entrepreneur and the benefits that he or she receives from the transaction.

Petitioner Domino’s insists that the reference in § 1981 to the right to “make and enforce contracts” grants to potential plaintiffs only the right to be free from racial discrimination in their own actual or prospective contractual relationship. But the words “their own” (or “his own”) simply are not to be found in the language of § 1981. The failure of Congress to include such a limitation cannot be dismissed as a mere slip of the legislative pen. Section 1981 should be accorded a sweep as broad as its language. Section 1981 provides that all persons have a right to be free from discrimination “to make and enforce contracts,” not merely to make and enforce their own contracts.

Respondent asserts that his ability to engage in business and sell his labor free from racial discrimination lies at the core of § 1981’s protections. The provisions of § 1981 regarding discrimination in contracting were enacted to guarantee the personal right to engage in economically significant activity free from racially discriminatory interference. Congress adopted the 1866 Civil Rights Act as a comprehensive charter designed to protect the hard-won liberty of the freedmen and to ensure that they could rely on their skills and initiative to advance their economic interests. The protections enumerated in § 1 of the act encompassed every right that the framers knew or could foresee that the former slaves might require in order to participate fully in economic life. Congress stopped short of an unrestricted prohibition against all forms of discrimination only because of a concern that it might be construed to extend to political rights. The rights enacted in § 1 should be given full effect and construed to reach new devices and schemes intended to deny individuals the ability to hold and enjoy the proceeds of their toil on the basis of race.

The zone of interests protected by a statute such as § 1981, which is directed at racial discrimination, is manifestly different from the zone of interests protected by traditional contract law. The basic purpose of the common law of contracts, and of statutes such as the Uniform Commercial Code providing for the enforcement of contracts, is to protect the interests of contracting parties and of certain intended third-party beneficiaries. Thus, if a state-law contract action were brought against Domino’s, the zone of interests protected by Nevada contract law presumably would be limited to JWM, as a contracting party, and to any intended third-party beneficiaries. But the purpose of § 1981 is to protect against racial discrimination. The overarching purpose of Reconstruction was not to deal with a sudden rash of contract violations, but to secure the freedom of the former slaves and to ensure that they could participate in the economic life of the nation unencumbered by racial discrimination. Thus, the interests asserted by McDonald to conduct business and to be compensated for his labor unimpeded by racial discrimination lie at the very heart of the concerns that § 1981 was fashioned to address.

Respondent argues that § 1981 protects the actual targets of discrimination even when they do business through a corporate intermediary. Racial discrimination based on the race of the owner or employees of a corporation easily falls within the scope of § 1981. In modern business transactions, corporations often play an essential intermediate role. Where racial discrimination related to contracts occurs because of the race of a corporation’s owner-operator, the owner-operator is the actual target of that unlawful discrimination, while the corporation itself is an intermediate victim. In the modern world, a number of practical, economic, legal, and tax considerations may compel individuals to conduct their affairs through corporations or other intermediate parties. If in those cases an entity could lawfully discriminate against someone because of his or her race, millions of American workers would fall outside the protections of § 1981.
If § 1981 did not permit recovery of the damages sustained by the actual target of discrimination whenever a corporation or other intermediary was involved, significant injuries caused by violations of § 1981 would go unredressed. There are a number of types of discriminatory practices that will injure only the actual target of the discrimination, but not the intermediate person or entity. For example, racial harassment of an owner or employee of a corporation will not injure the corporation itself unless it somehow causes lost profits. In the case now before the Court, McDonald asserts that Domino's officials engaged in a number of actions that injured McDonald personally but could not have harmed JWM, including threats, verbal abuse, and interference with McDonald's personal business activities. In Domino's view, none of these injuries, however intentional or foreseeable, would be actionable under § 1981. The complaint in this case sought damages for the pain and suffering, mental anguish, and humiliation suffered by McDonald. This sort of noneconomic injury is one of the most serious consequences of discriminatory action. It is an injury for which only individuals can seek redress. Corporations do not themselves have feelings. When owners or employees are the actual targets of discrimination and as a result suffer distinct personal injuries, permitting them to obtain redress for those injuries will not impose excessive liability on the wrongdoer. Those individual plaintiffs may only obtain damages for personal injuries that are separate from the harms suffered by a related corporation. The courts are competent to ensure that no double recovery occurs. The total amount of damages will be no greater than would have been awarded if the discrimination had been inflicted on a sole proprietorship. The only difference will be that that amount will be divided among the several victims.

Respondent McDonald believes that § 1981 does not impose on entrepreneurs a Hobson's choice of either giving up the right to incorporate or forsaking full relief for violations of the right to be free from discrimination. Petitioner Domino's argues that an entrepreneur who chooses to do business through a corporation thereby forfeits the right to redress for personal injuries that would have been compensable under § 1981 if he or she had been doing business as a sole proprietorship. The interpretation of § 1981 advocated by Domino's would work just such a forfeiture, denying relief under § 1981 to minority entrepreneurs who for a variety of legal and practical reasons must incorporate. McDonald contends that Congress cannot have intended to impose such a Hobson's choice on the victims of racial discrimination.

Neither the development of modern corporation law nor the growing complexity of federal income tax law could have been foreseen by the Congress that adopted the 1866 Civil Rights Act. But assuredly neither that Congress, nor the Congress that adopted the 1991 Civil Rights Act amending § 1981, intended to compel entrepreneurs to abandon the protections or the possibility of full redress under § 1981 if they chose to conduct their business through a corporation. The imposition of such a forfeiture would codify in federal law the very type of discriminatory barriers to economic self-advancement that § 1981 was enacted to prevent.

Finally, the respondent maintains that its claim fits within the normal claims that arise under § 1981. The claims that are cognizable under § 1981 share three critical elements. They involve (1) purposeful racial discrimination by the defendant, (2) directed intentionally at a person who is the plaintiff or a party with whom the plaintiff is in privity (that is, with whom the plaintiff has a contractual relationship), (3) that is intended to impair the formation, performance, enforcement, or enjoyment by the plaintiff of the benefits of a specific contractual opportunity. Although none of these elements requires a contractual relationship between the plaintiff and the discriminator, they nonetheless cabin the category of cases that can be brought. For example, a plaintiff whose car was destroyed in a racially motivated firebombing would fail to state a § 1981 claim if he alleged only that the defendant interfered with his housing rights and intimidated him. While the defendant's act could conceivably be related to some potential contractual opportunity, if a plaintiff fails to point to any specific contract with which the defendant had interfered, he fails to state a claim. By contrast, in this case, the complaint alleges each of the elements of a § 1981 claim against a third-party discriminator. First, it alleges racial animus by Domino's. Second, the complaint alleges that Domino's racially discriminatory conduct was directed intentionally at McDonald and the business he owned. Thus, respondent was not an incidental victim of Domino's discriminatory actions, which were directed at respondent in his capacity as owner-operator or JWM, the complaint clearly alleges that Domino's discrimination impaired his contracts with JWM. According to the respondent, the critical flaw in Domino's analysis is that it assumes that § 1981 authorizes suit only by persons whose own right to "make and enforce contracts" has been infringed. This necessarily means

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that the plaintiff's right must involve a contract with the defendant. To the contrary, however, as long as the plaintiff is alleging that the discrimination intentionally impaired his right to make a contract, the fact that the discriminators' own contractual rights and responsibilities are not at issue is irrelevant.

SIGNIFICANCE
Section 1981 is one of the bedrock federal statutes designed to protect an individual's civil rights. The title to the section is "Equal rights under the law." The statute provides that "all persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts." Although the statute defines what it means to make and enforce contracts, it does not define whether an individual must be a party to the contract to have standing to assert a claim under the § 1981.

The respondent, a minority entrepreneur, asserts that § 1981 must be broadly construed to address all racial discrimination that may cause one to be denied his or her equal rights under the law. The fact that he chose to conduct his business in a representative capacity should not deprive him of the right to bring a claim for racial discrimination. On the other hand, Domino's believes that before one can assert standing under the contract language of § 1981, one must be a party to the contract. The scope of § 1981 is a very significant issue, and in this case the Supreme Court may define its reach.

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Equal Employment Advisory Council et al. (Ann Elizabeth Reesman (202) 789-8600)
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