APPLYING THE ECONOMIC LOSS RULE IN TEXAS

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Under what circumstances, and to what extent, does the economic loss rule[1] bar recovery of pure economic losses in tort?

Defense lawyers routinely defend against economic damages by invoking "the economic loss rule," and courts often reference "the economic loss rule" as if there were one unitary rule applicable to tort actions generally.[2] The over-simplification misleads.

Multiple court opinions define the economic loss rule with a statement similar to this: "[T]he 'economic-loss rule' bars recovery in tort when a party suffers economic loss unaccompanied by harm to his own person or

[1] Numerous cases make reference either to the "economic loss rule" (sometimes the "economic loss doctrine") or to the "independent injury rule" (sometimes the "independent injury doctrine"). The "economic loss rule" and the "independent injury rule" are effectively references to the same concept, although they approach the concept from somewhat different viewpoints. *See infra* Part I.C.

[2] *See* Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 534–35 (2009) (quoted in Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 415 (Tex. 2011)).

property."[3] Exceptions to such a broadly stated "rule" then appear to be so numerous that they overwhelm the original rule.[4] Confusion abounds.

Judges and practitioners are not alone in their struggle to make sense of a "rule" seemingly riddled with exceptions. The American Law Institute (ALI) has struggled as well. The *Restatement (Third) of Torts: Products Liability* implicitly recognizes an economic loss rule in the context of products liability.[5] However, outside of product liability claims, neither the *Restatement (Second) of Torts* nor the *Restatement (Third) of Torts* addresses a more general economic loss rule or the inconsistencies apparent between cases and jurisdictions. This omission seems shocking since economic loss represents a huge commercial torts category for business litigants.[6] The ALI has attempted to produce order out of chaos by formulating a proposed "Restatement (Third) for Economic Torts and Related Wrongs."[7] The ALI Council considered Council Draft No. 1 in 2006 and Council Draft No. 2 in 2007.[8] Neither proposal was accepted, and work ceased for several years.[9] Work on a Restatement project for

[3] Wiltz v. Bayer CropScience, Ltd. P'ship, 645 F.3d 690, 695 (5th Cir. 2011) ("In most jurisdictions, the 'economic-loss rule' bars recovery in tort when a party suffers economic loss unaccompanied by harm to his own person or property."); *see also* Nazareth Int'l, Inc. v. J.C. Penney Corp., No. CIV.A. 304CV1265M, 2005 WL 1704793, at *7 (N.D. Tex. 2005) ("The economic loss rule is defined as 'the principle that a plaintiff cannot sue in tort to recover for purely monetary loss—as opposed to physical injury or property damage—caused by the defendant.'").

[4] *See* R. Joseph Barton, Note, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 WM. & MARY L. REV. 1789, 1789 (2000) ("The economic loss rule is stated with ease but applied with great difficulty. . . . Lawyers and judges alike have found it difficult to determine when the rule applies and when an exception is appropriate." (citation omitted)).

[5] *See* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 (1998) (harm to persons or property includes economic loss if caused by harm to the plaintiff's person, or to the person of another when that interferes with a protected interest of the plaintiff, or to the plaintiff's property other than the defective product itself).

[6] *See* discussion *infra* Part III.A.

[7] Copy of RESTATEMENT (THIRD) OF ECONOMIC TORTS AND RELATED WRONGS (Council Draft No. 1 October 2, 2006), and of RESTATEMENT (THIRD) OF ECONOMIC TORTS AND RELATED WRONGS (Council Draft No. 2 October 5, 2007), on file with author.

[8] *See supra* note 7.

[9] *See* THE AM. LAW INST., *Projects-Restatement Third, Torts: Liability for Economic Harm*, http://www.ali.org/index.cfm?fuseaction=projects.proj_ip&projectid=15 (last visited February 13, 2012).

"Torts: Liability for Economic Harm" resumed in 2010.[10] Thus far, no part of the work has been approved by the Council or by the membership.[11] This Restatement quandary is reflective of the conflicting interpretations that exist between (and often within) various state and federal jurisdictions.

The Texas Supreme Court correctly labels any reference to a single "economic loss rule" as a "misnomer."[12] "[T]here is not one economic loss rule broadly applicable throughout the field of torts, but rather several more limited rules that govern recovery of economic losses in selected areas of the law."[13]

This article is written—first and foremost—for practitioners. It seeks to help lawyers understand the scope of and various rationales for an economic loss rule, as well as the limits and exceptions applicable to the "rule" (or rules), with particular focus on Texas case law.

It is vital for practitioners (and trial judges) who are involved in financial litigation to fully grasp the economic loss rule.[14] Business owners, investors, and property holders are the parties most likely to seek recovery for a purely economic loss.[15] Defense lawyers who are fighting these economic loss claims obviously need to know when and how to apply the economic loss rule.[16] And the attorneys who are seeking to recover these economic losses for their clients must already be prepared to deal with the economic loss rule long before it is ever formally raised for the first time in a case because the economic loss rule is not an affirmative defense that must be pleaded.[17] As discussed in the initial section of this article, it is a stealth weapon that may be asserted for the first time in a motion for summary judgment (after discovery is complete) or in the court charge

[10] *Id.*

[11] *Id.*

[12] Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 415 (Tex. 2011).

[13] *See* Johnson, *supra* note 2, at 534–35.

[14] *See, e.g.*, Hou-Tex, Inc. v. Landmark Graphics, 26 S.W.3d 103, 106–07 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

[15] *See, e.g.*, Signal Oil & Gas Co. v. Universal Oil Prods., 572 S.W.2d 320, 325 (Tex. 1978) ("[W]here only the product itself is damaged, such damage constitutes economic loss recoverable only as damages for breach of an implied warranty under the [Business and Commerce] Code."); *see also* discussion *infra* Part IV.

[16] *See* Anita Bernstein, *Keep It Simple: An Explanation of the Rule of No Recovery for Pure Economic Loss*, 48 ARIZ. L. REV. 773, 773 (2006).

[17] *See infra* Part I.A.

conference at the end of trial (after the presentation of evidence is complete).[18]

I. WHAT IS THE ECONOMIC LOSS RULE?

The "economic loss rule" is a judicially-created limitation on the recovery of economic damages in some forms of tort actions.[19] It is not, however, a "rule" that is uniformly applied, in large part because courts struggle to blend two distinctly different rationales for its application.[20] Some U.S. jurisdictions apply a version of an economic loss rule in the context of both rationales,[21] some only in the context of one rationale,[22] and some ignore or reject any application of an economic loss rule.[23]

A. Not an Affirmative Defense

It helps to start with what the economic loss rule is not. It is not an affirmative defense that must be pleaded. [24] It is, instead, a statement or legal consideration of what is and is not to be considered as part of the proper measure of damages in a case to which it applies.[25]

This means that the economic loss rule may be raised by the defendant to simply point out a deficiency in the plaintiff's proof of damages, without the necessity of prior pleading.[26] It is this facet that allows the economic loss rule to be asserted for the first time after the close of discovery (in a motion for summary judgment) or after the close of evidence (in objecting

[18] *See infra* Part I.A.; *see also* text accompanying *infra* note 27.

[19] *See, e.g.*, Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965).

[20] *See infra* Part II.

[21] *See* Wiltz v. Bayer CropScience, Ltd. P'ship., 645 F.3d 690, 697–700 (5th Cir. 2011).

[22] *See, e.g.*, Barber Lines A/S v. M/V Donau Maru, 764 F.2d 50, 54–55 (1st Cir. 1985).

[23] *See, e.g.*, People Express Airlines, Inc. v. Consol. Rail Corp., 495 A.2d 107, 114–16 (N.J. 1985).

[24] *See* Equistar Chems., L.P. v. Dresser-Rand Co., 240 S.W.3d 864, 867–68 (Tex. 2007).

[25] *Id.*; *see also*, Tarrant Cnty. Hosp. Dist. v. GE Automation Servs., Inc., 156 S.W.3d 885, 895 (Tex. App.—Fort Worth 2005, no pet.) ("[T]he economic loss rule is not an affirmative defense . . . but is a court-adopted rule for interpreting whether a party is barred from seeking damages in an action alleging tort injuries resulting from a contract between the parties."). It is true that the economic loss rule is described (somewhat imprecisely) as "a liability defense or remedies doctrine" in *Lamar Homes, Inc.*, but that generalized description was used simply to distinguish the rule from being wrongly interpreted as a test for insurance coverage. Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 12–13 (Tex. 2007).

[26] *See Equistar*, 240 S.W.3d at 868.

to the plaintiff's requested submission to the jury on damages).[27] As will be discussed in this article, there are various potential arguments for avoidance of the economic loss rule, but those arguments are often dependent on how the case has been pleaded by the plaintiff and what evidence of damages has been procured and offered by the plaintiff.[28] Early anticipation of the economic loss rule issue is imperative.

B. What Qualifies as Economic Loss

Traditionally, "pure economic loss" has been defined as "loss that is not itself a consequence of personal injury or property damage."[29] But that often begs the question: What is the definitional difference between "property damage" and "economic loss"?

In its recent *Sharyland* opinion, the Texas Supreme Court has taken issue with the concept that "some physical destruction of tangible property must occur" in order for there to be "property damage."[30] Sharyland Water Supply Corporation sued the City of Alton's contractors after the contractors negligently installed sewer lines above portions of the corporation's water system in violation of state law, threatening the water system with contamination.[31] The court of appeals had reversed the trial

[27] *See id.* Because the economic loss rule helps determine the proper measure of damages (i.e. the kinds of damages allowed), however, the party relying on the rule must object to a damage question in the charge which would submit an improper measure of damage to the jury. The Texas Supreme Court held that the defendant in *Equistar* waived its argument for application of the economic loss rule by failing to object to submission of a damage question which made no distinction between tort and contract damage remedies, a potential $3.6 million oversight. *Id.*

[28] *See, e.g.*, Acad. of Skills & Knowledge, Inc. v. Charter Schl., USA, Inc., 260 S.W.3d 529, 542 (Tex. App.—Tyler 2008, pet. denied) ("In light of the language found throughout ASK's pleading and used to define the relationship between ASK and CSUSA, we must conclude that the injuries complained of by ASK are 'to the subject of the contract itself.' Therefore, ASK's negligence cause of action, as pleaded, was barred by the economic loss rule."); Sterling Chems., Inc. v. Texaco Inc., 259 S.W.3d 793, 797 (Tex. App.—Houston [1st Dist.] 2007, pet. denied) ("The burden is on the plaintiff claiming negligent misrepresentation to provide evidence of this independent injury.").

[29] William Powers, Jr. & Margaret Niver, *Negligence, Breach of Contract, and the "Economic Loss" Rule*, 23 TEX. TECH L. REV. 477, 478 (1992).

[30] Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 418 (Tex. 2011). The lower court had held that "property damage cannot consist merely of damage to an intangible asset or increased operational costs. Instead, some physical destruction of tangible property must occur." City of Alton v. Sharyland Water Supply Corp., 277 S.W.3d 132, 154 (Tex. App.—Corpus Christi 2009), *aff'd in part, rev'd in part*, 354 S.W.3d 407 (Tex. 2011).

[31] *Sharyland*, 354 S.W. 3d at 410–11.

court judgment, finding that there was no property damage and thus the economic loss rule applied, barring Sharyland from recovering in tort.[32] The Texas Supreme Court has reversed the court of appeals, determining that negligence necessitating repairs and remediation constitutes property damage even in the absence of physical destruction of property:

> [T]he court of appeals erred in concluding that Sharyland's water system had not been damaged. Sharyland's system once complied with the law, and now it does not. Sharyland is contractually obligated to maintain the system in accordance with state law and must either relocate or encase its water lines. . . . Costs of repair necessarily imply that the system was damaged, and that was the case here. . . . We disagree that the economic loss rule bars Sharyland's recovery in this case.[33]

This holding makes sense. To hold otherwise would potentially allow application of the economic loss rule so as to prevent the repair and remediation necessary to mitigate further damage and safety risks.

Lower court cases which attempt to distinguish between property damage and economic loss in other contexts include *Admiral Insurance Co. v. Little Big Inch Pipeline Co.*[34] (diminution in property value alone constitutes economic damage, but physical changes to property constitute property damage) and *Sterling Chemicals, Inc. v. Texaco Inc.*[35] (lost sales and profits constitute economic losses).[36]

[32] *Id.* at 411.

[33] *Id.* at 420 (citations omitted).

[34] 523 F. Supp. 2d 524, 538–39 (W.D. Tex. 2007).

[35] 259 S.W.3d 793, 798 (Tex. App.—Houston [1st Dist.] 2007, pet denied).

[36] One of the most interesting arguments for limiting the definition of economic loss is based on Texas Civil Practice and Remedies Code Sections 41.001(4) and 41.001(12), which exclude "injury to reputation and all other nonpecuniary losses of any kind" from the definition of economic damages. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(4), (12) (West 2008). The next section, Section 41.002(a), states that "[t]his chapter applies to any action in which a claimant seeks damages relating to a cause of action." TEX. CIV. PRAC. & REM. CODE ANN. § 41.002(a) (West 2008). Application of this statutory definition to the economic loss rule was rejected in *Sanitarios Lamosa*, where the federal district court held that the court-made economic loss rule is not limited by a legislative definition of economic loss. Sanitarios Lamosa, S.A. de C.V. v. DBHL, Inc., No. Civ.A. H-04-22973, 2005 WL 2405923, at *3 (S.D. Tex. Sept. 29, 2005).

C. Definitions of the Economic Loss Rule

To make sense of an economic loss rule, we need to briefly examine some of its commonly-stated definitions, and then delve into the most common rationales for its existence.

In Texas, the definition of the economic loss rule utilized most often states that a plaintiff should only be able to recover in contract and not in tort when injury is limited to just economic loss to the subject of a contract (with pure economic loss meaning a financial loss that is unaccompanied by an independent physical injury to the plaintiff's person or other property).[37] Some courts label this version of the economic loss rule as the "independent injury rule," based on the idea that tort law should not be used to recover economic damages between parties to a contract unless one of the parties has suffered an "independent injury" extending beyond just economic loss to the subject of the contract.[38]

This version of the economic loss rule, however, is merely one formulation of the rule, and it does not provide the answer in all situations. For instance, while the Texas Supreme Court has repeatedly held that an injury of purely economic loss to the subject of the contract sounds in contract alone,[39] the Texas Supreme Court has also held that when a claim of fraudulent inducement is involved, "tort damages are recoverable . . . irrespective of whether the fraudulent representations are later subsumed in

[37] *See, e.g.*, Martin K. Eby Const. Co. v. LAN/STV, 350 S.W.3d 675, 686 (Tex. App.—Dallas 2011, pet. filed), and cases cited therein.

[38] The court in *Eastman Chemical*, advocates replacing use of the term "economic loss rule" with the term "independent injury doctrine" when evaluating the potential tort recovery of economic damages between contractual parties, but usage of the alternate label is limited. Eastman Chem. Co. v. Niro, Inc., 80 F. Supp. 2d 712, 716 n.2 (S.D. Tex. 2000); *see, e.g.*, Regus Mgmt. Grp., LLC, v. Int'l Bus. Mach. Corp., No. 3:07-CV-1799-B, 2008 WL 1836360, at *6 (N.D. Tex. 2008) (economic loss doctrine, better described as the independent injury rule, essentially bars a plaintiff from attempting to convert a contract action into a tort action); Esty v. Beal Bank S.S.B., 298 S.W.3d 280, 301 **(**Tex. App.—Dallas 2009, no pet.) (tort damages are generally not recoverable unless the plaintiff suffered an injury that is independent and separate from the economic losses recoverable under a breach of contract claim); Exxon Mobil Corp. v. Kinder Morgan Operating L.P., 192 S.W.3d 120, 126–27 (Tex. App.—Houston [14th Dist.] 2006, no pet.) (describing independent injury rule).

[39] Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 494–95 (Tex. 1991) (quoting Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986)); *see also* Equistar Chems., L.P. v. Dresser-Rand Co., 240 S.W.3d 864, 867 (Tex. 2007) ("The economic loss rule applies when losses from an occurrence arise from failure of a product and the damage or loss is limited to the product itself.").

a contract or whether the plaintiff only suffers an economic loss related to the subject matter of the contract."[40]

In a number of Texas lower court cases, the economic loss rule has been used to bar tort actions for economic losses despite the lack of any kind of contractual privity between the parties, meaning that there is no "subject of the contract."[41] Some of these courts (as well as various federal district courts applying Texas law) have defined the economic loss rule more broadly without reference to any "subject of the contract," such as with this statement:

> To be entitled to damages for negligence, a party must plead and prove either a personal injury or property damage as contrasted to mere economic harm. Among the policy reasons supporting this rule is the difficulty, if not impossibility, of placing a reasonable limit on a defendant's liability to those who suffer solely economic damages caused by a negligent action.[42]

As will be discussed in more detail in this article, the Texas Supreme Court has recently confronted the question of whether the economic loss rule can be broadly defined as always blocking the tort (negligence)

[40] Formosa Plastics Corp. USA v. Presidio Eng'rs and Contractors, Inc., 960 S.W.2d 41, 47 (Tex. 1998).

[41] *See, e.g.*, Hou-Tex, Inc. v. Landmark Graphics, 26 S.W.3d 103, 106–07 (Tex. App.—Houston [14th Dist.] 2000, no pet.) (applying the rule to preclude tort recovery for costs of a dry well against a software designer whose software did not properly predict where to drill, where there was no contractual privity between the plaintiff and the software designer).

[42] Express One Int'l, Inc. v. Steinbeck, 53 S.W.3d 895, 899 (Tex. App.—Dallas 2001, no pet.); *see also* Mem'l Hermann Healthcare Sys. Inc. v. Eurocopter Deutschland, GMBH, No. G-06-438, 2007 WL 2446787, at *2 (S.D. Tex. Aug. 23, 2007) ("[A]ll negligence claims are barred by the economic loss doctrine."); StormWater Structures, Inc. v. Platipus Anchors, Inc., 764 F. Supp. 2d 842, 849 (S.D. Tex. 2011) ("[T]he economic loss rule bars recovery for economic damages when the loss is the subject matter of a contract between the parties, or, when two parties are not in contractual privity, when the tort claims are based upon pure economic loss with no accompanying physical personal or physical property damage."). Invocation of a broadened version of the economic loss rule has likewise been applied to defective product claims, including strict liability, without regard to whether or not a contractual relationship exists. *See, e.g.*, Clems Ye Olde Homestead Farms Ltd. v. Briscoe, No. 4:07cv285, 2008 WL 5146964, at *4 (E.D. Tex. Dec. 8, 2008) ("[T]ort claims are also precluded against a manufacturer or seller of a defective product where the only damage is that to the product with no concomitant personal injury or property damage. This rule has been extended to those who are not in contractual privity . . . ." (citations omitted)).

recovery of purely economic damages, concluding that "such broad statements are not accurate." [43] The Texas Supreme Court indicated at least two problems with that kind of blanket prohibition:

> [That assertion] both overstates and oversimplifies the economic loss rule. To say that the economic loss rule "preclude[s] tort claims between parties who are not in contractual privity" and that damages are recoverable only if they are accompanied by "actual physical injury or property damage," overlooks all of the tort claims for which courts have allowed recovery of economic damages even absent physical injury or property damage.[44]

There is a lack of uniformity across jurisdictions regarding the kinds of tort actions to which the economic loss rule is to be applied.[45] Courts disagree as to whether and under what circumstance the economic loss rule presents a bar to negligence-based torts, and to what extent the bar reaches to intentional torts such as fraud, conversion, tortious interference with contract or business relations, or knowing participation in breach of fiduciary duty.

Much of the disagreement and confusion results from applying the "economic loss rule" label to two distinctly different rationales.[46] When different policy reasons exist in different factual settings for denying (or allowing) the recovery of purely economic losses, use of the same label for these very different discussions and outcomes makes confusion inevitable.

In actuality, there are consistent policy reasons that undergird the formulations of the economic loss rule by the Texas Supreme Court. The

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[43] *See* Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 418 (Tex. 2011) (citations omitted) (quoting Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 874 (9th Cir. 2007)).

[44] *Id.* (citations omitted).

[45] In stark contrast to some of overly-inclusive definitions previously referenced for the economic loss rule, U.S. District Court Judge Gray Miller presents a more understated view of its reach: "The economic loss doctrine is most commonly associated with products liability claims; however, some jurisdictions apply the limitation on recovery outside of that realm." Quicksilver Res., Inc. v. Eagle Drilling, L.L.C., No. H-08-868, 2009 WL 1312598, at *13 (S.D. Tex. 2009).

[46] More gifted authors have extensively explored multiple theoretical rationales for the economic loss rule, including the two primary rationales discussed in this article. *See, e.g.*, Robert L. Rabin, *Respecting Boundaries and the Economic Loss Rule in Tort*, 48 ARIZ. L. REV. 857 (2006); Bernstein, *supra* note 16; Johnson, *supra* note 2; Barton *supra* note 4.

only way to truly make sense of the confusion is to first clarify the policy reasons for such a rule to even exist.

II. WHAT ARE THE RATIONALES FOR THE ECONOMIC LOSS RULE?

One rationale for an economic loss rule seeks to protect the boundary line between contract and tort. This is the rationale which produces the statement that a plaintiff should only be able to recover in contract and not in tort when injury is limited to an economic loss to the subject of a contract (i.e. unaccompanied by physical injury to the plaintiff's person or property).[47]

A completely separate rationale for an economic loss rule focuses on protecting tortfeasors (whose torts have nothing to do with any contract) from unlimited liability. This is often the rationale generating the broader, more sweeping statements of an economic loss rule, such as the statement that a plaintiff cannot recover damages for negligently-caused financial harm, even when foreseeable, except in special circumstances such as physical injury to the plaintiff or the plaintiff's property.[48]

Since these two rationales serve different concerns in two very different settings (one in a commercial setting governed by contractual concerns, the other in a pure tort setting with no contractual relationship), they generate different applications of and exceptions to an economic loss rule.[49]

[47] Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 12–13 (Tex. 2007) (economic loss rule generally precludes recovery in tort for economic losses resulting from the failure of a party to perform under a contract, even when the failure might reasonably be viewed as a contracting party's negligence).

[48] *See, e.g.*, Barber Lines A/S v. M/V Donau Maru, 764 F.2d 50, 57 (1st Cir. 1985) (dismissing negligence claims by shipowners seeking recovery of damages from another ship due to a fuel oil spill into harbor).

[49] Different courts and commentators propose a variety of other possible rationales for an economic loss rule, in addition to the two primary rationales discussed here. For example, a Fifth Circuit case applying Louisiana law lists four possible rationales, including two that are not usually listed as positive reasons: predictability of result (by uniformly denying the recovery of economic loss in tort actions generally) and encouragement of first-party insurance coverage over third-party liability coverage. Wiltz v. Bayer CropScience, Ltd. P'ship., 645 F.3d 690, 696–697 (5th Cir. 2011).

A. Rationale #1: Protecting the Line Between Contract and Tort

The most common justification for the economic loss rule is to properly protect the boundary between contract law and tort law.[50] In broad terms, contract law exists to regulate and enforce expectations arising from the private agreements of parties, while tort law exists to regulate and enforce expectations generally applicable to the public without regard to the existence of a contract. The economic loss rule is premised on the belief that the law of contracts is usually better suited to resolve an issue of purely economic loss between parties to a contract (or between parties in a contractual-type relationship, such as the sale of a product), because the parties have had the opportunity to allocate between them the risks of pure economic harm.[51] Enforcing contract rather than tort remedies in this situation, where money is a complete remedy for pure economic harm, tends to promote an informed and more efficient allocation of the risks of economic harm.[52] Imposing tort remedies for pure economic loss between contracting parties threatens to disrupt these risk allocations and the role of contract law, unless there is an independent reason that supersedes this concern.[53]

What is an example of an independent reason for imposing tort law despite the existence of a contractual relationship? The classic example is the occurrence of personal injury resulting from negligent performance of a contract. The buyer of a product may be expected to contractually allocate the economic risk of the product failing to perform as promised, but as a general proposition the buyer is not expected to have contractually allocated the risk of physical injury from a defect in the product. Tort law is better suited than contract law to enforce a duty to protect the public from negligent physical harm.

What are other examples of an independent duty to protect the public generally without regard to a contractual relationship?

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[50] *Lamar Homes, Inc.*, 242 S.W.3d at 12–13 ("In operation, the rule restricts contracting parties to contractual remedies for those economic losses associated with the relationship, even when the breach might reasonably be viewed as a consequence of a contracting party's negligence.")

[51] E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 872–73 (1986) ("Contract law, and the law of warranty in particular, is well suited to commercial controversies of the sort involved in this case because the parties may set the terms of their own agreements.").

[52] *See id.* at 874.

[53] *See id.*

- Protection of property (other than property that is the subject of a contract between the parties) from physical injury (as opposed to merely financial injury).[54]

- Protection from being fraudulently induced into a contract, since no one should have the right to defraud another party into a contract and then claim the terms of the fraudulently-induced contract as a defense.[55]

- Protection from a fiduciary's violation of a fiduciary duty, since a fiduciary should not be allowed to use a position of trust and authority to establish a contract that benefits the fiduciary at the expense of the other party.[56]

- Protection from the violation of an independent legal duty established to protect the public generally, such as a legal duty governing the proper installation of a municipal sewage system.[57]

- Other examples of independent duties are discussed in Part IV of this article.[58]

This means that, unless there is a superseding independent duty involved, there generally should be no tort liability for pure economic harm simply based upon the negligent performance of a contract resulting in loss to the subject of a contract. The New Jersey Supreme Court explained:

[54] A classic example is found in *Sharyland Water Supply Corp. v. City of Alton*, 354 S.W.3d 407 (Tex. 2011), a case which is discussed at multiple points in this article.

[55] *See, e.g.*, Formosa Plastics Corp. USA v. Presidio Eng'rs and Contractors, Inc., 960 S.W.2d 41, 46 (Tex. 1998); *see also infra* Part IV (discussing *Formosa Plastics*).

[56] *See, e.g.*, ERI Consulting Eng'rs, Inc. v. Swinnea, 318 S.W.3d 867, 873 (Tex. 2010) (noting actual damages as well as fee forfeiture are recoverable for breach of fiduciary duty, a fiduciary who breaches his duty should not be insulated from forfeiture if the party whom he fraudulently induced into contract is ignorant about the fraud, or fails to suffer harm).

[57] Again, a classic example is found in *Sharyland*, 354 S.W.3d at 407, a case which is discussed at multiple points in this article.

[58] *See infra* Part IV.

> The purpose of a tort duty of care is to protect society's interest in freedom from harm, *i.e.*, the duty arises from policy considerations formed without reference to any agreement between the parties. A contractual duty, by comparison, arises from society's interest in the performance of promises. Generally speaking, tort principles, such as negligence, are better suited for resolving claims involving unanticipated physical injury, particularly those arising out of an accident. Contract principles, on the other hand, are generally more appropriate for determining claims for consequential [economic] damage that the parties have, or could have, addressed in their agreement.[59]

In other words, the economic loss rule attempts to limit a contracting party to recovery only on a contract cause of action unless the contracting plaintiff can demonstrate an independent duty that as a matter of public policy cannot be contracted away, or independent harm beyond mere disappointed economic expectations. Outside of these independent duty/independent harm situations, if the existing contract or contractual relationship fails to provide an adequate remedy, theoretically the plaintiff has only himself to blame for failing to make a better deal.[60] One commentator noted:

> The economic loss rule performs a valuable function in determining which economic losses are actionable only under contract law and not under tort principles. However, just as contract law should not be allowed to drown in a "sea of tort," the principles of tort law should not be permitted to drown in a "sea of contract."[61]

Or as another commentator states: "Quite simply, the economic loss rule 'prevent[s] the law of contract and the law of tort from dissolving one into the other.'"[62]

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[59] Spring Motors Distribs., Inc. v. Ford Motor Co., 489 A.2d 660, 672 (N.J. 1985); *see also* Neibarger v. Universal Coop., Inc., 486 N.W.2d 612, 615 (Mich. 1992) (distinguishing the purposes of contract remedies and tort remedies in a contractual relationship).

[60] *See* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 870 (1986).

[61] Johnson, *supra* note 2, at 583–584, (quoting Grams v. Milk Prods., Inc., 699 N.W.2d 167, 180 (Wis. 2005) (quoting from *E. River S.S. Corp.*, 476 U.S. at 866 (1986))).

[62] Barton, *supra* note 4, at 1796 (May 2000) (quoting Rich Prods. Corp. v. Kemutec, Inc., 66

B. Rationale #2: Putting Limits on Negligence Actions in Non-Contract Settings

A second body of case law has developed which applies (or declines to apply) the economic loss rule in situations where there is no suggestion of contract or privity between the parties, nor any commercial transaction which has produced economic expectations at the heart of the case.[63] In federal maritime litigation and in a number of state jurisdictions, a variation of the economic loss rule has been invoked simply to place a limit on how far tort actions, particularly negligence actions, can reach.[64] For example, the First Circuit noted:

> [C]ases and commentators point to pragmatic or practical administrative considerations which, *when taken together*, offer support for a rule limiting recovery for negligently caused pure financial harm. The number of persons suffering foreseeable financial harm in a typical accident is likely to be far greater than those who suffer traditional (recoverable) physical harm. The typical downtown auto accident, that harms a few persons physically and physically damages the property of several others, may well cause financial harm (e.g., through delay) to a vast number of potential plaintiffs. The less usual, negligently caused, oil spill foreseeably harms not only ships, docks, piers, beaches, wildlife, and the like, that are covered with oil, but also harms blockaded ships, marina merchants, suppliers of those firms, the employees of marina businesses and suppliers, the suppliers' suppliers, and so forth. To use the notion of "foreseeability" that courts use in physical injury cases to separate the financially injured allowed to sue from the financially injured not allowed to sue would draw vast numbers of injured persons within the class of potential plaintiffs in even the most simple accident cases (unless it leads courts, unwarrantedly, to narrow the scope of "foreseeability" as applied to persons suffering physical harm). That possibility—a large number of different plaintiffs each with somewhat different claims—

F. Supp. 2d 937, 969 (E.D. Wis. 1999)).

[63] *See, e.g.*, Barber Lines A/S v. M/V Donau Maru, 764 F.2d 50 (1st Cir. 1985).

[64] *See id.* at 54.

> in turn threatens to raise significantly the cost of even relatively simple tort actions.[65]

The desire to protect the boundary between contract and tort does not explain this type of application of an economic loss rule. A separate function of the economic loss rule—at least as applied in many but not all jurisdictions—is to simply constrain the reach of tort law even when the case does not arise from a contractual relationship or a commercial transaction with disappointed economic expectations.[66]

When the economic loss rule is applied in this manner, it results in an arbitrary limitation on negligence actions (and, in some jurisdictions, other tort actions) to allow recovery for economic harm only if accompanied by physical injury to the plaintiff or to the plaintiff's property. The Texas Supreme Court has already signaled its unwillingness to apply this broadly encompassing version of the economic loss rule:

> To say that the economic loss rule "preclude[s] tort claims between parties who are not in contractual privity" and that damages are recoverable only if they are accompanied by "actual physical injury or property damage," overlooks all of the tort claims for which courts have allowed recovery of economic damages even absent physical injury or property damage.[67]

Because of the seemingly unfair results which can result in those jurisdictions that do apply this broad-form version of the economic loss rule, a host of exceptions often accompany this version of the rule in order to ameliorate at least some of the worst injustices.[68] The Texas Supreme Court has been more judicious in its choices. The court has refrained from announcing as a general rule that the economic loss rule prohibits the tort recovery of purely economic damages between contractual strangers, and then subsequently riddling that general rule with numerous exceptions.[69]

The Texas Supreme Court does not rule out the potential for applying the economic loss rule in the absence of contractual privity—"the question

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[65] *Id.* (citations omitted).

[66] *See id.* at 51.

[67] Sharyland Water Supply Corp. v. Alton, 354 S.W.3d 407, 418 (Tex. 2011) (citations omitted).

[68] *See Barber Lines*, 764 F.2d at 56.

[69] *Sharyland*, 354 S.W.3d at 415–18.

is not whether the economic loss rule should apply where there is no privity of contract (we have already held that it can)"[70]—but it has also properly permitted the recovery of economic loss in a variety of non-privity situations (such as negligent misrepresentation,[71] fraud,[72] and business disparagement[73]) in which economic harm to clearly ascertainable parties is the foreseeable result of the defendant's breach of a tort duty, and for which there has been no contractual allocation of risks between the parties. In each of these latter situations, application of a general economic loss rule would essentially allow a tortfeasor to take unfair financial advantage of an individual or business, without accountability, leaving a plaintiff without a remedy under either contract law or tort law.

Instead of endorsing one overly-broad economic loss rule to serve this second rationale of placing limits on the reach of negligence or other tort actions in the absence of a contractual relationship, the Texas Supreme Court has moved very cautiously. It has essentially endorsed the idea that the so-called economic loss rule is actually composed of more limited and distinct rules applicable to narrower types of cases.[74] Discussion of these Texas cases and the potential direction of future cases is contained in Part IV of this article.[75]

C. The Question of Blending Rationales

These two rationales—protecting the line between contract and tort, and putting limits on negligence and other tort actions between parties outside of contractual relationships—have a history of simply being blended by many courts.[76] Consider this explanation for applying the economic loss rule from a recent Fifth Circuit opinion:

[70] *Id.* at 418 ("Although we applied this rule even to parties not in privity (e.g., a remote manufacturer and a consumer), we have never held that it precludes recovery completely between contractual strangers in a case not involving a defective product . . . .").

[71] *See, e.g., id.* at 418 n.14.

[72] *See, e.g., id.* at 418 n.18.

[73] *See, e.g., id.* at 419 n.23.

[74] *See id.* at 415 ("[T]here is not one economic loss rule broadly applicable throughout the field of torts, but rather several more limited rules that govern recovery of economic losses in selected areas of the law.").

[75] *See infra* Part IV.

[76] *See, e.g.*, Wiltz v. Bayer CropScience, Ltd. P'ship., 645 F.3d 690, 697 (5th Cir. 2011).

> [F]or "policy reasons," the law does not "require that a party who negligently causes injury to property must be held legally responsible to *all* persons for *all* damages flowing in a 'but for' sequence from the negligent conduct." . . . [T]he plaintiffs here could have allocated the risk of a supply disruption by negotiating enforceable supply contracts in the first place. Indeed, by not negotiating such contracts, the plaintiffs would appear to have made a choice to bear the risk of a supply disruption, presumably because they did not think that risk was worth the cost of reallocation or insurance. The plaintiffs' own business calculation is not a sound reason to impose indefinite liability on Bayer.[77]

Again, the Texas Supreme Court has taken a more limited approach, resisting the blending of these distinctly different rationales.[78] In its recent *Sharyland* opinion, it has rejected the argument that, since the plaintiff *theoretically could have* contractually allocated its risk with *someone*, the economic loss rule should be applied to eliminate a tort remedy for negligence between contractual strangers:

> Merely because the [defective] sewer was the subject of *a* contract does not mean that a contractual stranger is necessarily barred from suing a contracting party for breach of an independent duty. If that were the case, a party could avoid tort liability to the world simply by entering into a contract with one party. The economic loss rule does not swallow all claims between contractual and commercial strangers.[79]

III. HISTORICALLY, HOW HAS THE ECONOMIC LOSS RULE DEVELOPED IN U.S. CASE LAW?

As U.S. District Court Judge Eldon E. Fallon states, "To put these issues in proper context it is helpful to review the origins and purpose of the

[77] *Id.* at 697–700.

[78] *See, e.g.*, *Sharyland*, 354 S.W.3d at 418.

[79] *Id.* at 419.

[economic loss rule because] 'a page of history is worth a volume of logic.'"[80]

A. Origins of the Economic Loss Rule to Protect the Boundary Between Contract and Tort

Judicial disagreement about where and how to define the boundaries between tort and contract is not a modern phenomenon. What has now been labeled as the economic loss rule, however, was first explained in the 1965 case of *Seely v. White Motor Company* by the California Supreme Court in the context of a product liability claim:

> The distinction that the law has drawn between tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary. . . . The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products. He can appropriately be held liable for physical injuries caused by defects by requiring his goods to match a standard of safety defined in terms of conditions that create unreasonable risks of harm. He cannot be held for the level of performance of his products in the consumer's business unless he agrees that the product was designed to meet the consumer's demands. A consumer should not be charged at the will of the manufacturer with bearing the risk of physical injury when he buys a product on the market. He can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will. *Even in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone*.[81]

The *Seely* opinion expressly disagreed with a New Jersey opinion from four months earlier, in which the New Jersey Supreme Court held that a consumer could pursue a strict liability tort remedy against a manufacturer

[80] *In re* Chinese Manufactured Drywall Prods. Liab. Litig., 680 F. Supp. 2d 780, 788 (E.D. La. 2010) (partially quoting Justice Holmes in *N.Y. Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921)).

[81] Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965) (emphasis added).

for a defective product, even in the absence of privity of contract and even though the plaintiff's damage was limited to the economic loss of value of the product itself.[82]

Over the next twenty years, the *Seely* rationale increasingly held sway. The *Restatement (Third) of Torts: Products Liability* implicitly endorsed an economic loss rule in the field of products liability.[83] More states adopted some variety of tort strict liability for physical injuries caused by a defective product, coupled with the economic loss rule to limit or bar strict liability for purely economic loss alone.[84] Many of these courts struggled, however, with precise formulations of the economic loss rule, especially when applied to other than product liability cases. To what extent should the economic loss rule limit or bar other tort theories (beyond strict liability) for economic loss? And should the economic loss rule extend to limit or bar recovery when there has been no personal injury but there has been injury to property other than the product itself?

In 1982, the Illinois Supreme Court rendered an influential opinion in *Moorman Manufacturing Co. v. National Tank Co.*[85] After acknowledging arguments for and against application of an economic loss rule, the court sided with the California Supreme Court in holding that a manufacturer's liability is limited to damages for physical injuries and there should be no recovery for economic loss alone.[86] Further, in defining the limits of the economic loss rule, the Illinois Court endorsed dicta from the California *Seely* opinion and held that "physical injury" should be interpreted broadly so as to include not only injury to the person, but also physical injury *to other property that is distinct from the product in question*.[87] Thus, in its articulation of "economic loss," the Illinois Supreme Court held that a plaintiff may not recover under strict liability for economic loss alone, but

[82] *Id.* (expressly disagreeing with Santor v. A & M Karagheusian, Inc., 207 A.2d 305 (N.J. 1965)).

[83] *See* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 21 (1997) (harm to persons or property includes economic loss if caused by harm to the plaintiff's person, or to the person of another when that interferes with a protected interest of the plaintiff, or to the plaintiff's property other than the defective product itself).

[84] *See, e.g.*, Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443, 448 (Ill. 1982).

[85] *Id.* The influence of this opinion has caused some courts and commentators to refer to the economic loss rule as the *Moorman* doctrine.

[86] *Id.* at 448–49.

[87] *Id.*

this rule does not prevent recovery when there has been physical injury to the person or other property of the plaintiff.[88]

Four years later, the U.S. Supreme Court weighed in with a federal maritime case in *East River Steamship Corp. v. Transamerica Delaval, Inc.*[89] In that case, the plaintiff alleged shipbuilding product defects that had resulted in economic loss to the plaintiff.[90] Due to statute of limitations issues, the plaintiff dismissed its contractual claims and proceeded only on tort theories.[91] In the Court's view, *East River* involved disappointed economic expectations of a commercial party who had entered into a contract and allocated risks based on foreseeable consequences, and who should therefore be limited to its contract and breach of warranty actions.[92] Although the case addressed the economic loss rule only in the context of maritime law and therefore had no binding effect upon the states, its influence has been great. The Supreme Court detailed its analysis and rationale, starting with the public policy concerns involved in product liability actions:

> Products liability grew out of a public policy judgment that people need more protection from dangerous products than is afforded by the law of warranty. It is clear, however, that if this development were allowed to progress too far, contract law would drown in a sea of tort. We must determine whether a commercial product injuring itself is the kind of harm against which public policy requires manufacturers to protect, independent of any contractual obligation. . . . For similar reasons of safety, the manufacturer's duty of care was broadened to include protection against property damage. Such damage is considered so akin to personal injury that the two are treated alike.[93]

[88] *Id.* at 449.

[89] 476 U.S. 858 (1986).

[90] *Id.* at 861.

[91] *Id.*

[92] *Id.* at 870.

[93] *Id.* at 866–67 (citations omitted).

The Court further provided:

> Exercising traditional discretion in admiralty we adopt an approach similar to *Seely* and hold that a manufacturer in a commercial relationship has no duty under either a negligence or strict products-liability theory to prevent a product from injuring itself. . . . When a product injures only itself the reasons for imposing a tort duty are weak and those for leaving the party to its contractual remedies are strong. The tort concern with safety is reduced when an injury is only to the product itself. When a person is injured, the "cost of an injury and the loss of time or health may be an overwhelming misfortune," and one the person is not prepared to meet. In contrast, when a product injures itself, the commercial user stands to lose the value of the product, risks the displeasure of its customers who find that the product does not meet their needs, or, as in this case, experiences increased costs in performing a service. Losses like these can be insured. . . . Contract law, and the law of warranty in particular, is well suited to commercial controversies of the sort involved in this case because the parties may set the terms of their own agreements. The manufacturer can restrict its liability, within limits, by disclaiming warranties or limiting remedies. In exchange, the purchaser pays less for the product. Since a commercial situation generally does not involve large disparities in bargaining power we see no reason to intrude into the parties' allocation of the risk. . . . Permitting recovery for all foreseeable claims for purely economic loss could make a manufacturer liable for vast sums. . . . "The law does not spread its protection so far."[94]

East River clearly directs its application of the economic loss rule to products, which fail to meet a plaintiff's economic expectations from a commercial transaction. For those damages limited to failed economic expectations between parties to a transaction, the Court reasoned that the

[94] *Id.* at 871–74 (citations omitted).

law of warranties and contract were already well suited to address those concerns without the intervention of tort law.[95]

Following the Supreme Court's *East River* opinion, the economic loss rule clearly gained the upper hand among jurisdictions considering whether or not it should be applied in the setting of a commercial transaction, to the point that even some states which had previously rejected the economic loss rule subsequently chose to apply it.[96] *East River*, however, did not answer all of the questions associated with the economic loss rule. It simply applied the economic loss rule in connection with strict liability claims, and did not suggest whether the economic loss rule should also be applied as a limitation on other tort actions, particularly in the absence of some kind of commercial relationship.

In the quarter century since *East River* was decided, state courts (as well as federal courts applying state law and federal maritime law) have addressed these questions, with often conflicting results. A broad overview of competing arguments for and against application of the economic loss rule in commercial transactions appears in a recent opinion from the federal MDL court charged with management of the Chinese dry wall litigation.[97] In applying Florida, Alabama, Mississippi and Louisiana law, the federal MDL court held that the economic loss rule does not bar tort claims for Chinese dry wall which serves its intended purpose of supporting walls but which poses risks to health and property and must therefore be replaced.[98] The court's reasoning is helpful in understanding the policy rationale being served by the economic loss rule in a commercial transaction, as well as potential limits on that rationale:

> The [*East River*] Court justified barring plaintiff's tort remedy on the basis that plaintiff still had breach of

[95] *Id.* at 872–73.

[96] For example, the New Jersey Supreme Court, which had previously held in *Santor v. A & M Karagheusian, Inc.*, 207 A.2d 305, 312 (N.J. 1965), that a consumer could pursue a strict liability tort remedy against a manufacturer for a defective product even though plaintiff's damage was limited to the economic loss of value of the product itself, changed course and recognized the economic loss rule for this type of claim in *Alloway v. Gen. Marine Indus., L.P.*, 695 A.2d 264 (N.J. 1997).

[97] *In re* Chinese Manufactured Drywall Prods. Liab. Litig., 680 F. Supp. 2d 780, 791–92 (E.D. La. 2010) (MDL court finding that economic loss rule does not bar tort actions arising from allegedly defective Chinese drywall installed in homes, applying state law from Florida, Alabama, Mississippi, and Louisiana).

[98] *Id.*

> warranty and breach of contract remedies against the manufacturer, both of which the Court found appropriate since the commercial parties had entered into an agreement, allocating risk, and the malfunction was foreseeable. . . . [Here] the Plaintiffs are not in privity with the Manufacturer and Distributor Defendants, so they, unlike the plaintiff in *East River*, are not left with breach of contract and breach of warranty actions against these defendants . . . . In the instant matter, the Chinese drywall has not been destroyed, nor has it ceased to function for its intended purpose; rather, it is contaminating the health and homes of the Plaintiffs. Further, the instant matter goes beyond the concerns . . . of "increased costs of doing business" and "customer displeasure," to concerns with the destruction of Plaintiffs' homes and the deterioration of Plaintiffs' health.[99]

B. Origins of the Economic Loss Rule to Limit Negligence Actions in Non-Contract Settings

Although the phrase "economic loss rule" first gained traction in conjunction with the *Seely* line of cases seeking to protect the line between contract and tort, over time the phrase was also applied to this separate line of cases pursuing the second rationale, to limit the reach of negligence cases between parties who are complete strangers with no contractual or commercial relationship.[100]

The flagship case touted for this second rationale is actually a U.S. Supreme Court maritime case decided several decades prior to the California *Seely* case, and which makes no mention of an economic loss rule. In *Robins Dry Dock & Repair Co. v. Flint*, a shipyard contracted with the owner of a ship to make repairs to the ship in dry dock.[101] In the course of these repairs the shipyard negligently damaged the ship's propeller, which extended the ship's stay in dry dock.[102] A charterer who was to have use of the ship following repairs suffered economic loss as a result of the

[99] *Id.* at 792, 95.

[100] *See, e.g.*, Barber Lines A/S v. M/V Donau Maru, 764 F.2d 50, 51 (1st Cir. 1985).

[101] 275 U.S. 303, 307 (1927).

[102] *Id.*

ship's extended stay in dry dock.[103] The charterer, who had a contract with the ship owner but who was a contractual stranger to the shipyard, brought suit against the shipyard for recovery of the economic losses.[104]

The U.S. Supreme Court stated the issue for decision as follows: "The question is whether the [plaintiffs] have an interest protected by the law against unintended injuries inflicted upon the vessel by third persons who know nothing of the [plaintiffs'] charter."[105] In response the Court held:

> Of course the contract of the [defendant shipyard] with the owners imposed no immediate obligation upon the [defendant shipyard] to third persons as we already have said, and whether the [defendant shipyard] performed it promptly or with negligent delay was the business of the owners and of nobody else. But as there was a tortious damage to a chattel it is sought to connect the claim of the [plaintiffs] with that in some way. The damage was material to them only as it caused the delay in making the repairs, and that delay would be a wrong to no one except for the [defendant shipyard's] contract with the owners. The injury to the propeller was no wrong to the [plaintiffs] but only to those to whom it belonged. But suppose that the respondent's loss flowed directly from that source. [The plaintiff's] loss arose only through [its] contract with the owners—and while intentionally to bring about a breach of contract may give rise to a cause of action, no authority need be cited to show that, as a general rule, at least, a tort to the person or property of one man does not make the tortfeasor liable to another merely because the injured person was under a contract with that other unknown to the doer of the wrong. The law does not spread its protection so far.[106]

The holding of this case has subsequently been cited in various jurisdictions as justification for a much broader proposition, that economic loss simply should not be recoverable based on a claim of negligence

[103] *Id.*

[104] *Id.*

[105] *Id.* at 308.

[106] *Id.* at 308–09 (citations omitted).

between contractual strangers.[107] In actuality, the case only supports the proposition that a stranger to a contract has no standing to sue in negligence for breach of a duty that exists only pursuant to a contract with someone else, and therefore should not be entitled to bring a claim for negligence *in the absence of any independent duty otherwise existing outside of the contract*.[108] Nevertheless, the case is often cited for the far more expansive rule of barring all negligence actions for pure economic loss, presumably to add the imprimatur of Supreme Court authority.[109]

Later maritime cases applying this more expansive interpretation of *Robins*, such as *Barber Lines A/S v. M/V Donau Maru*[110] and *Louisiana ex rel. Guste v. M/V Testbank*,[111] buttress their reasoning with the concern that a large number of different plaintiffs claiming only financial losses might overwhelm liable parties with unlimited tort claims if *Robins* were not followed. Yet this concern is not voiced as any part of the *Robins* rationale.

Instead, influential legal writers such as Professor Fleming James, Jr., drawing from other cases, articulated this rationale and used it to reinterpret and "pragmatically" explain the *Robins* case after the fact.[112] This interpretation presumes that traditional negligence foreseeability principles will result in crushing liabilities for tortfeasors whose carelessness affects the public generally.[113] The economic loss rule provides a pragmatic limitation on this threat of crushing liability by restricting claims to only those brought for personal injury or damage to proprietary interests in property.[114] When this interpretation is applied as a bright line rule, claims for pure economic loss unaccompanied by injury to person or property are barred. Language from *Robins* (e.g., that "the law does not spread its protection so far") has subsequently been cited in support of this rationale.[115]

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[107] *See, e.g.*, Barber Lines A/S v. M/V Donau Maru, 764 F.2d 50, 51 (1st Cir. 1985).

[108] *Robins Dry Dock & Repair Co.*, 275 U.S. at 308–09.

[109] *See, e.g.*, *Barber Lines*, 764 F.2d at 51.

[110] *Id.*

[111] 752 F.2d 1019, 1022 (5th Cir. 1985); *see also* Catalyst Old River Hydroelectric Ltd. P'ship. v. Ingram Barge Co., 639 F.3d 207, 210 (5th Cir. 2011).

[112] *See* Fleming James, Jr., *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43, 45 (1972).

[113] *See id.*

[114] *Id.*

[115] *See, e.g.*, *Barber Lines*, 764 F.2d at 51.

Within federal maritime law, most circuits have accepted application of an economic loss rule that generally bars pure economic loss claims unaccompanied by injury to person or property.[116] Outside of maritime, numerous state courts have applied some version of this economic loss rule, but the application has been uneven across jurisdictions and riddled with exceptions, which seek to avoid the harsh results of a rule that can be arbitrary in effect.[117]

For example, even within maritime cases, commercial fishermen enjoy a recognized exception to the economic loss rule.[118] Although they fish in waters that they neither own nor license, and therefore cannot claim injury to a property right, they are allowed to recover pure economic losses in the event of pollution.[119] Classification of a claim as one for nuisance can circumvent application of an economic loss rule.[120] Exceptions abound across jurisdictions for various other negligence-based torts such as negligent misrepresentation,[121] legal malpractice,[122] and loss of consortium (despite being a claim for economic loss with no physical injury to the claimant),[123] as well as a host of intentional torts.

Some states, such as Texas (at least at the supreme court level), have never embraced this version of the economic loss rule, while some other states have expressly rejected it. The New Jersey Supreme Court pushed back against the initial acceptance of this type of economic loss rule in *People Express Airlines, Inc. v. Consolidated Rail Corp.*[124] The business plaintiff in *People Express* suffered economic losses when the airport terminal from which it conducted operations was closed down by the defendant's nearby toxic spill.[125] The New Jersey Supreme Court, after detailing the rationale and counter-arguments for this version of the economic loss rule, found a physical harm requirement for recovery of

[116] *See, e.g.*, Yarmouth Sea Prods. v. Scully, 131 F.3d 389, 398 (4th Cir. 1997).

[117] *See Barber Lines*, 764 F.2d at 56.

[118] *See, e.g.*, *Yarmouth Sea Prods.*, 131 F.3d at 398.

[119] *Id.* at 399.

[120] *See, e.g.*, Holcomb Const. Co., Inc. v. Armstrong, 590 F.2d 811, 813 (9th Cir. 1979).

[121] *See, e.g.*, Level 3 Commc'ns, LLC v. Liebert Corp., 535 F.3d 1146, 1163 (10th Cir. 2008).

[122] *See, e.g.*, Resolution Trust Corp. v. Holland & Knight, 832 F. Supp. 1528, 1532 (S.D. Fla. 1993).

[123] *See, e.g.*, Wolfgang v. Mid-Am. Motorsports, Inc., 914 F. Supp. 434, 438 (D. Kan. 1996).

[124] 495 A.2d 107, 114–16 (N.J. 1985).

[125] *Id.* at 108–09.

economic damages to be unnecessarily arbitrary and instead opted for a limited foreseeability analysis:

> We hold therefore that a defendant owes a duty of care to take reasonable measures to avoid the risk of causing economic damages, aside from physical injury, to particular plaintiffs or plaintiffs comprising an identifiable class with respect to whom defendant knows or has reason to know are likely to suffer such damages from its conduct. A defendant failing to adhere to this duty of care may be found liable for such economic damages proximately caused by its breach of duty.
>
> We stress that an identifiable class of plaintiffs is not simply a foreseeable class of plaintiffs. For example, members of the general public, or invitees such as sales and service persons at a particular plaintiff's business premises, or persons travelling on a highway near the scene of a negligently-caused accident, such as the one at bar, who are delayed in the conduct of their affairs and suffer varied economic losses, are certainly a foreseeable class of plaintiffs. Yet their presence within the area would be fortuitous, and the particular type of economic injury that could be suffered by such persons would be hopelessly unpredictable and not realistically foreseeable. Thus, the class itself would not be sufficiently ascertainable. An identifiable class of plaintiffs must be particularly foreseeable in terms of the type of persons or entities comprising the class, the certainty or predictability of their presence, the approximate numbers of those in the class, as well as the type of economic expectations disrupted.
>
> . . . .
>
> We conclude therefore that a defendant who has breached his duty of care to avoid the risk of economic injury to particularly foreseeable plaintiffs may be held liable for actual economic losses that are proximately caused by its breach of duty. In this context, those economic losses are recoverable as damages when they are the natural and probable consequence of a defendant's negligence in the sense that they are reasonably to be

> anticipated in view of defendant's capacity to have foreseen that the particular plaintiff or identifiable class of plaintiffs, as defined *infra* at 263–64, is demonstrably within the risk created by defendant's negligence.[126]

In 2007, the Ninth Circuit discussed the uneven acceptance of an economic loss rule broadly applied beyond its first rationale:

> Some jurisdictions have yet to apply the economic loss doctrine outside the product liability context.
>
> . . . .
>
> The economic loss doctrine in product liability cases can be easily stated.
>
> . . . .
>
> However, the economic loss doctrine has not been confined to product liability cases. When applied in cases outside the product liability context, the doctrine has produced difficulty and confusion. In such cases, as lamented by the Florida Supreme Court, "the [economic loss] rule has been stated with ease but applied with great difficulty."[127]

In fact, in *Indemnity Insurance Co. of North America v. American Aviation, Inc.*, the Florida Supreme Court limited its application of the economic loss rule to cases of product liability and contractual privity.[128] And it was this "great difficulty" of applying the economic loss rule beyond its initial moorings that resulted in the inability of the ALI to reach a consensus view regarding proper application of the rule.[129]

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[126] *Id.* at 116–18 (citations omitted); *see also In re* Heartland Payment Sys., Inc. Customer Data Sec. Breach Litig., No. H 10 171, 2011 WL 1232352, at *21 (S.D. Tex. March 31, 2011), in which U.S. District Court Judge Lee Rosenthal analyzes the current status of the economic loss rule under New Jersey law.

[127] Giles v. Gen. Motors Acceptance Corp., 494 F.3d 865, 873–74 (9th Cir. 2007) (citing Indem. Ins. Co. of N. Am. v. Am. Aviation, Inc., 891 So. 2d 532, 544 (Fla. 2004) (Cantero, J., concurring)) (internal quotation marks and citations omitted).

[128] 891 So. 2d at 543 (cases that do not fall into the categories of products liability and contractual privity should be decided on traditional negligence principles of duty, breach, and proximate cause).

[129] *See supra* Part III, *infra* Part IV and V.

Essentially, the debate related to this second rationale for an economic loss rule has progressed to two basic viewpoints: either apply a majority approach (at least of those jurisdictions which have addressed this aspect of economic loss recovery) establishing a bright line economic loss rule to bar negligence and potentially other tort actions for pure economic losses, subject to numerous exceptions to ameliorate some of the arbitrary results, or employ a minority approach that rejects such a broad economic loss rule in favor of a more traditional but restricted foreseeability analysis, limiting plaintiffs to those claimants with particularized damages beyond those of the public generally and who are specifically identifiable as being at risk before the tort.

IV. HOW HAS THE ECONOMIC LOSS RULE DEVELOPED IN TEXAS CASE LAW?

The Texas Supreme Court has applied the economic loss rule in only two related, overlapping contexts,[130] both of which serve to differentiate between contract and tort actions involving parties in a contractual setting:

> 1. The economic loss rule has been applied to prevent a plaintiff from asserting tort claims against a defendant for disappointed economic expectations arising from a contractual relationship.[131]
>
> 2. The Texas Supreme Court has utilized the economic loss rule to bar product liability tort claims when the damage or loss is limited to the product itself, relegating a

[130] There are many cases, particularly federal district court cases, which have summarized Texas law regarding the economic loss rule with a statement to the effect that Texas recognizes the economic loss rule in three settings, and includes within that list not only the two categories recognized by the Texas Supreme Court, but also a third category involving tort claims for pure economic damages between parties not in contractual privity. *See, e.g.*, StormWater Structures, Inc. v. Platipus Anchors, Inc., 764 F. Supp. 2d 842, 847 (S.D. Tex. 2011). It is important to note that these statements regarding this third category are based on opinions from Texas lower courts which are no longer good authority in light of the recent case of Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 420 (Tex. 2011).

[131] *See, e.g.*, Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 494 (Tex. 1991) (when the only loss or damage is to the subject matter of the contract, the plaintiff's action is ordinarily on the contract); Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986) (when the injury is only the economic loss to the subject of a contract itself the action sounds in contract alone).

> buyer's recovery to quasi-contract theories such as breach of implied warranties.[132]

The pronouncements of the Texas Supreme Court to date provide us with the contours for understanding how the economic loss rule is applied in Texas, but they do not answer all the questions. The following subsections identify the basic principles and exceptions that appear to be established, as well as questions remaining to be answered by the Texas Supreme Court.

A. Strict Liability Claims for Product Defects

Across the nation, the question of an economic loss rule first arose in product strict liability actions, and the same held true in Texas.[133]

A decade after introduction of the economic loss rule in California,[134] the Texas Supreme Court first applied it in the context of a product liability claim in *Nobility Homes of Texas v. Shivers*.[135] The plaintiff in *Nobility Homes* had purchased a mobile home.[136] By the time the plaintiff learned that the mobile home was defective and unfit for its intended purpose, the mobile home dealer had gone out of business.[137] The plaintiff sued the manufacturer, asserting breach of implied warranty and strict liability, and sought recovery of the difference between the purchase price and the lower actual value of the mobile home.[138]

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[132] *See, e.g.*, Equistar Chems., L.P. v. Dresser-Rand Co., 240 S.W.3d 864, 867 (Tex. 2007) (recognizing economic loss rule precludes tort recovery when losses arise from failure of a product and the damage or loss is limited to the product itself); Signal Oil & Gas Co. v. Universal Oil Prods., 572 S.W.2d 320, 325 (Tex. 1978) (in transactions between a commercial seller and commercial buyer, when no physical injury has occurred to persons or other property, injury to the defective product itself is an economic loss governed by the Uniform Commercial Code); Nobility Homes of Tex., Inc. v. Shivers, 557 S.W.2d 77, 80–81 (Tex. 1977) (where only the product itself is damaged, such damage constitutes economic loss recoverable only as damages for breach of an implied warranty).

[133] *Nobility Homes*, 557 S.W.2d at 79.

[134] Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875, 86 (1997) (Scalia, J., dissenting).

[135] 557 S.W.2d at 79–80.

[136] Nobility Homes of Tex. Inc. v. Shivers, 539 S.W.2d 190, 191 (Tex. Civ. App.—Beaumont 1976), *aff'd*, 557 S.W.2d 77 (Tex. 1977).

[137] *Id.*

[138] *Id.*

When the Court turned to the issue of recovery of economic loss for a defective product via strict liability, it was persuaded by the *Seely* line of authority.[139] The Texas Supreme Court specifically quoted from *Seely*:

> The law of sales [i.e., the Uniform Commercial Code (UCC)] has been carefully articulated to govern the economic relations between suppliers and consumers of goods. The history of the doctrine of strict liability in tort indicates that it was designed, not to undermine the warranty provisions of the sales act or of the [UCC] but, rather, to govern the distinct problem of physical injuries.[140]

The Texas Supreme Court accordingly held that strict liability for a defective product could not be used to recover for economic loss in the absence of physical injury to person or property.[141]

Following on the heels of the *Nobility Homes* case, the Texas Supreme Court considered whether economic loss should be recoverable in the absence of physical injury to person or property (other than to the defective product alone) if the product was found to be unreasonably dangerous.[142] Again, the answer was no. In *Mid Continent Aircraft Corp. v. Curry County Spraying Service, Inc.*, the owner of a plane survived a plane crash without personal injury and without injury to property other than to the plane itself.[143] The plaintiff sued three defendants who had been part of constructing and selling the plane.[144] The plane was found by the trial court to have been sold in an unreasonably dangerous condition.[145] The Texas Supreme Court applied the economic loss rule:

> The present case does not involve personal injury but concerns only economic loss to the purchased product itself. Distinguished from personal injury and injury to other property, damage to the product itself is essentially a

[139] *Nobility Homes*, 557 S.W.2d at 80.

[140] *Id.* (quoting from Seely v. White Motor Co., 403 P.2d 145, 149 (Cal. 1965)) (citations omitted).

[141] *Id.* at 79–80.

[142] Mid Continent Aircraft Corp. v. Curry Cnty. Spraying Serv., Inc., 572 S.W.2d 308 (Tex. 1987).

[143] *Id.* at 310.

[144] *Id.* at 309.

[145] *Id.* at 310.

> loss to the purchaser of the benefit of the bargain with the seller. . . . In transactions between a commercial seller and commercial buyer, when no physical injury has occurred to persons or other property, injury to the defective product itself is an economic loss governed by the [UCC].[146]

The rationale for these decisions is clear: the economic loss rule applies in product defect cases when the only injury is purely economic loss to the product itself because that type of loss is best regulated by contractual and quasi-contractual remedies, not by tort law. Only if there is physical injury to the plaintiff or the plaintiff's other property should tort law and tort remedies come into play.

B. Negligence Actions Between Contractual Parties

Given that the Texas Supreme Court applied the economic loss rule to product defect claims in order to protect the distinct functions of contractual and tort remedies, it was natural for the court to extend the reach of the economic loss rule to negligence cases arising in the midst of a contractual relationship between the parties.

1. *Scharrenbeck* and a Potential Tort in Every Contract

To understand the context for the Texas Supreme Court's application of the economic loss rule to negligence claims, we start with specific language from the 1947 Texas Supreme Court opinion of *Montgomery Ward & Co. v. Scharrenbeck*, which predated any recognition of the economic loss rule.[147]

In *Scharrenbeck*, the defendant contracted to repair a water heater in the plaintiff's home, but the defendant's faulty repair of the water heater caused a fire that completely destroyed the plaintiff's home.[148] The court held that the plaintiff's cause of action sounded in tort because the defendant owed a duty to the plaintiff to not negligently burn the home down in the course of performing the contract.[149] If the question were being decided today as to whether to allow a tort action for negligence to be pursued in this case, the answer would presumably be the same. The economic loss rule would have

[146] *Id.* at 312–13.

[147] 204 S.W.2d 508 (Tex. 1947).

[148] *Id.* at 509.

[149] *Id.* at 510.

no application to this case because the defendant's negligence caused physical injury to the plaintiff's other property.

In 1947, however, there was no reference to the non-applicability of an economic loss rule which had not even been articulated yet.[150] Instead, the court simply stated, "Accompanying every contract is a common-law duty to perform with care, skill, reasonable expedience and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of the contract."[151]

This language in *Scharrenbeck* was subsequently argued to be the recognition of a duty of care existing within all contracts; a breach of duty could therefore support a cause of action for negligence as well as for a breach of contract.[152] As a result, the broad language of *Sharrenbeck* opened the door for tort damages, including punitive damages, to be pleaded in any breach of contract claim.[153] In subsequent decades, however, with the advent of the economic loss rule and its adoption in Texas for product strict liability claims, it was natural for the Texas Supreme Court to consider application of the economic loss rule to cases involving claims between contractual parties. To do so, however, the court had to reconsider the breadth of its *Sharrenbeck* language.

2. Redefining *Scharrenbeck* with the *Reed/DeLanney* Factors

In two primary opinions (*Jim Walter Homes v. Reed*[154] and *Southwestern Bell v. DeLanney*[155]) coinciding with the rise of the economic loss rule across the United States, the Texas Supreme Court clarified its earlier *Scharrenbeck* holding. By doing so, the court recognized the economic loss rule as a potential bar to negligence claims arising from contractual relationships so as to protect the line between contracts and torts, and it established a structure for determining whether a cause of action sounds in tort or contract, or both.

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[150] *See supra* Part IV.A.

[151] *Sharrenbeck*, 204 S.W.2d at 510.

[152] *See, e.g.*, Aranda v. Ins. Co. of N. Am., 748 S.W.2d 210, 212 (Tex. 1988); Melody Home Mfg. Co. v. Barnes, 741 S.W.2d 349, 358 (Tex. 1987).

[153] *See, e.g.*, Jack Criswell Lincoln Mercury, Inc. v. Tsichlis, 549 S.W.2d 255, 259 (Tex. Civ. App.—Beaumont, 1977, no writ).

[154] Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986).

[155] Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 494 (Tex. 1991).

The plaintiffs in *Reed* contracted with a builder for the construction of their home.[156] The plaintiffs thereafter claimed the builder used poor quality materials and sued to recover damages for the alleged negligent construction of their home.[157] The jury awarded punitive damages, but the Texas Supreme Court found this was a breach of contract claim and reversed the punitive damages.[158] The court held:

> The acts of a party may breach duties in tort or contract alone or simultaneously in both. The nature of the injury most often determines which duty or duties are breached. When the injury is only the economic loss to the subject of a contract itself, the action sounds in contract alone.[159]

Using this "nature of the injury" test, the court reasoned that the injury to the plaintiffs was the failure to receive the house for which they had contracted and paid.[160] The economic loss the plaintiffs suffered was the subject of the contract itself (i.e. a well-constructed home); therefore, this was a breach of contract claim and not a tort claim.[161] This outcome, of course, remained fully consistent with the purpose of the economic loss rule articulated by the court for product defect claims (i.e. to protect the boundary between contract and tort claims).

In *Southwestern Bell Telephone Co. v. DeLanney*, the Court added another element to the test set forth in *Reed*. In *DeLanney*, the plaintiff claimed that Southwestern Bell negligently failed to publish his Yellow Pages advertisement as promised.[162] The Court of Appeals, relying on *Scharrenbeck*, held the plaintiff correctly submitted this to the jury as a negligence claim.[163] The Texas Supreme Court, however, found this dispute was limited to a breach of contract claim by looking at two criteria: (1) the nature of the plaintiff's injuries (the criterion discussed in *Reed*) and (2) the source of the defendant's duty in the cause of action.[164]

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[156] 711 S.W.2d at 617.

[157] Jim Walter Homes, Inc. v. Reed, 703 S.W.2d 701, 703–04 (Tex. App.—Corpus Christi 1985), *rev'd in part*, 711 S.W.2d 617 (Tex. 1986).

[158] *Jim Walter Homes*, 711 S.W.2d at 618.

[159] *Id.*

[160] *Id.*

[161] *Id.*

[162] Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 493–94 (Tex. 1991).

[163] *Id.* at 494.

[164] *Id.* at 494–95.

Like the plaintiff in *Reed*, the plaintiff in *DeLanney* suffered economic damages because of the defendant's failure to perform under the contract.[165] When Southwestern Bell failed to publish the advertisement, the plaintiff suffered past and future lost profits because potential customers did not see the advertisement.[166] However, these damages all flowed from the breach of the subject of the contract (the promise to properly advertise the plaintiff's business and phone number) and did not constitute a separate, independent injury.

Furthermore, with regard to this second "source of the duty" criterion, the only source of Southwestern Bell's duty to publish DeLanney's advertisement was the contract itself.[167] There was no independent duty imposed by law (i.e. outside of the duty created by the contract) requiring Southwestern Bell to publish the plaintiff's advertisement.[168] Based on both of these criteria (i.e. "nature of the injury" and "source of the duty"), the court concluded that this was a case best addressed pursuant to contractual remedies rather than tort remedies, and therefore applied the economic loss rule to bar a negligence recovery for a purely economic loss.[169]

In *DeLanney* the court specifically addressed its prior broad language in *Scharrenbeck* and attempted to harmonize that language with these more recent opinions. The court explained that in *Sharrenbeck* the defendant did in fact breach both a tort duty as well as a contractual duty, but then clarified that not every breach of a contract will also involve the commission of a tort.[170] The defendant in *Sharrenbeck* breached its contractual duty by failing to repair the water heater properly.[171] However, the law also implied an independent common-law duty on the defendant outside of the contract—a duty to act with reasonable skill and diligence in making the repairs so as not to injure a person or other property by his performance.[172] This breach of a common-law duty in that case gave rise to a cause of action in tort.[173] The Court explained:

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[165] *Id.* at 495.

[166] *See id.*

[167] *See id.*

[168] *See id.*

[169] *Id.*

[170] *Id.* at 494.

[171] *Id.*

[172] *Id.*

[173] *Id.*

> If a defendant's conduct—such as negligently burning down a house—would give rise to liability independent of the fact that a contract exists between the parties, the plaintiff's claim may also sound in tort. Conversely, if the defendant's conduct—such as failing to publish an advertisement—would give rise to liability only because it breaches the parties' agreement, the plaintiff's claim ordinarily sounds only in contract.[174]

Thus, the decision in *Sharrenbeck* was technically correct: the plaintiff did have a tort cause of action; however, not all breach of contract claims also give rise to tort claims, as subsequently explained by the Austin Court of Appeals:

> Outside of certain special contexts, such as insurance contracts, the mere breach of a contract is not a tort. However, the mere fact than an act is done pursuant to a contract does not shield it from the general rules of tort liability. Depending on the circumstances, a party's acts may breach duties in tort or contract alone or simultaneously in both.[175]

3. Applying the *Reed/DeLanney* Factors Rationally, Not Mechanically

The Texas Supreme Court has never explicitly clarified how the two *Reed/DeLanney* factors (i.e., nature of the injury and source of the duty) are to be balanced against each other when they point in opposite directions on the question of whether a negligence claim should be permitted between parties in contractual privity. For example, if the nature of the injury is the same injury that results from a breach of contract, but the duty giving rise to the tort claim is a duty that exists independently of any contract between the parties (and is not effectively modified by the contract), then which of these criteria takes precedence?[176]

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[174] *Id.*

[175] Thomson v. Espey Huston & Assocs., Inc., 899 S.W.2d 415, 420 (Tex.App.—Austin 1995, no writ) (citations omitted); *see, e.g.*, FKB Enters., LLC v. Capital Aviation, Inc., No. H 11 2334, 2011 WL 4708091, at *1–2 (S.D. Tex., Oct. 4, 2011) (explaining economic loss rule does not bar negligence action for damage to aircraft resulting from negligent removal and reinstallation of heat shield during performance of painting contract).

[176] Lower courts in Texas have periodically confronted this question of how to apply the two

The court has, however, made it clear in *DeWitt County Electric Cooperative., Inc. v. Parks* that the application of these factors is not to be done mechanically without resorting to the underlying rationale for the factors.[177]

The plaintiffs in *DeWitt* sued the electric utility in tort for negligently cutting down trees in the right-of-way granted to the utility company by contract.[178] The plaintiffs argued that, under the "nature of the injury" test, they were suing for the value of the trees rather than the value of the easement made the subject of the contract; and, under the "source of the duty" test, they were asserting a duty existing outside of the contract not to negligently cut down trees.[179] The court of appeals held that, based on the *Reed/DeLanney* factors, plaintiffs were entitled to proceed in tort.[180] The Texas Supreme Court disagreed:

> The court of appeals carried [these factors] to an illogical conclusion. A person who enters a neighbor's property and cuts down trees with no contractual right to do so can be held liable in tort. But when, as here, a contract spells out the parties' respective rights about whether trees may be cut, the contract and not common-law negligence governs

Reed/DeLanney factors when the factors point in competing directions, but the results have not been uniform. Some lower courts have only looked at the nature of the injury to determine if a cause of action is a tort. *See, e.g.*, Tarrant Cnty. Hosp. Dist. v. GE Automation Serv., 156 S.W.3d 885, 895 (Tex. App.—Ft. Worth 2005, no pet.). Other courts have looked first to the nature of the injury and then looked to the source of the duty as a secondary source. *See, e.g.*, *Thomson*, 899 S.W.2d at 420–21. Other courts have given the two criteria equal weight and balanced them against each other. *See, e.g.*, UMLIC VP LLC v. T & M Sales & Envtl. Sys. Inc., 176 S.W.3d 595, 613–15 (Tex. App.—Corpus Christi 2005, pet. denied). And yet other courts have appeared to give primary importance to the source of the duty. *See, e.g.*, Mortberg v. Litton Loan Servicing, L.P., No. 4:10 CV 668, 2011 WL 4431946, at *5 (E.D. Tex. Aug. 30, 2011). The Texas Supreme Court tends to define the economic loss rule with reference to the nature of the injury, *see, e.g.*, ½ Price Checks Cashed v. United Auto. Ins. Co., 344 S.W.3d 378, 387 (Tex. 2011) ("under the economic loss rule . . . a claim sounds in contract when the only injury is economic loss to the subject of the contract itself"), but when confronted with factors pointing in conflicting directions in *Formosa*, the Court chose to focus on the source of the duty to the exclusion of the nature of the injury. *See* Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 45–46 (Tex. 1998). Ultimately the Court has not suggested that one factor should ordinarily be given enhanced weight over the other.

[177] 1 S.W.3d 96, 105 (Tex. 1999).

[178] *Id.* at 98.

[179] *Id.* at 105.

[180] *Id.*

> any dispute about whether trees could be cut or how trees were cut.[181]

The "source of the defendant's duty" prong of the *Reed/DeLanney* criteria must be understood to include *the duty as modified by contract*. When the duty has been addressed and modified by the contract, then the source of the duty is no longer one that exists outside of and independent of the contract; the source of the duty now arises from the contract.

In light of the plaintiff's inability to demonstrate an independent duty arising outside of and continuing in effect outside of the contract, the court concluded that the plaintiff could not assert a negligence claim independently of a breach of contract claim.

C. Negligence Actions in the Absence of Contractual Privity Between Parties

With its new *Sharyland* opinion addressing issues with the economic loss rule, the Texas Supreme Court provides guidance on whether the economic-loss rule is generally applicable to all negligence claims for purely economic losses without regard to contractual privity.[182] The answer, in short, is that privity still matters.[183]

Before looking at this aspect of the *Sharyland* opinion, it is important to understand the development of lower court opinions regarding the interplay between the economic loss rule, negligence, and contractual privity.[184] In the intervening decade since the last of the Supreme Court's *Reed*, *DeLanney*, and *DeWitt* opinions, some Texas appellate courts had pushed beyond the Supreme Court's stated rationale for the economic loss rule.[185]

Several of these Texas appellate opinions had applied the economic loss rule to bar a claim for negligence or other tort against a third party with whom there is no contractual privity, in a circumstance in which a commercial transaction at least afforded the plaintiff the opportunity to contractually allocate the foreseeable risks of the transaction with another

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[181] *Id.*

[182] Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 420 (Tex. 2011).

[183] *Id.*

[184] *See, e.g.*, Trans-Gulf Corp. v. Performance Aircraft Servs., Inc., 82 S.W.3d 691, 694–95 (Tex. App.—Eastland 2002, no pet.); Coastal Conduit & Ditching Inc. v. Noram Energy Corp., 29 S.W.3d 282, 285–88 (Tex. App.—Houston [14th Dist.] 2000, no pet.); Hou-Tex, Inc. v. Landmark Graphics, 26 S.W.3d 103, 106–07 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

[185] *See supra*, note 176.

party.[186] It is within this line of cases that Texas appellate courts (but not the Texas Supreme Court) had made statements to the effect that "Texas state courts have consistently applied the economic-loss rule to negligence claims between parties who were not in privity."[187] The Houston Court of Appeals for the First District explained the reasoning:

> [A]pplication of the economic loss rule is particularly appropriate here, where permitting Sterling to sue Texaco for consequential damages for the failure of the syngas cooler would disrupt the risk allocations that Sterling bargained for in its contract with PHS and that PHS, in turn, contemplated in its contract with Texaco.[188]

In addition, a small number of Texas courts of appeals cases had gone even further, applying the economic-loss rule to negligence claims without any discussion of protecting risk allocations.[189] These opinions instead simply cited to the need to place limits on the reach of negligence cases.[190] The cases of *Coastal Conduit & Ditching Inc. v. Noram Energy Corp.*[191] and *Express One International, Inc. v. Steinbeck* provide the two primary examples.[192]

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[186] *Id.*

[187] Sterling Chems., Inc. v. Texaco Inc., 259 S.W.3d 793, 799 (Tex. App.—Houston [1st Dist.] 2007, pet. denied) (economic-loss rule applied to tort claim brought by Sterling Chemical against Texaco arising from transaction in which Sterling Chemical had contracted with another party which in turn had contracted with Texaco).

[188] *Id.* at 799–800. For other examples which would properly be categorized in this line of cases, *see also Hou-Tex*, 26 S.W.3d at 107 ("Permitting Hou-Tex to sue Landmark for economic losses would disrupt the risk allocations that Hou-Tex worked out in its contract with Saguaro and the risk allocations in Landmark's beta agreement or licensee agreement . . . ."); City of Alton v. Sharyland Water Supply Corp., 277 S.W.3d 132, 154 (Tex. App.—Corpus Christi 2009), *aff'd in part, rev'd in part*, 354 S.W.3d 407 (Tex. 2011) (Court of Appeals holding that economic loss rule applied to claim by water company against city's subcontractors who had installed sewer lines, reasoning that although water company was not in contractual privity with subcontractors, water company had a contract with the city upon which it could, and did, bring breach of contract claim).

[189] *See, e.g.*, Coastal Conduit & Ditching Inc. v. Noram Energy Corp., 29 S.W.3d 282, 285–86 (Tex. App.—Houston [14th Dist.] 2000, no pet.); Express One Int'l, Inc. v. Steinbeck, 53 S.W.3d 895, 899 (Tex. App.—Dallas 2001, no pet).

[190] *See Coastal Conduit & Ditching Inc*., 29 S.W.3d at 285–86.

[191] *Id.*

[192] *See* 53 S.W.3d at 899 (whether former employee could be liable in negligence for posting damaging message in employer's name to internet message board).

The first of these two lines of lower court opinions is best understood as a blending of the two potential economic loss rule rationales discussed in Part II.[193] Theoretically, these opinions sought to protect a possible line between contract and tort by enforcing a supposed risk allocation in which parties not in privity had nevertheless had the opportunity to consider and decline entering into contractual safeguards.[194] By applying the economic loss rule, these courts sought to protect the right of parties to contractually determine their fate (whether that opportunity realistically ever existed or not).[195] These opinions must also be understood, however, as an attempt to curb the reach of negligence claims generally, the second rationale served by the economic-loss rule, since they are enforcing the economic-loss rule in a situation where no contractual privity exists.[196]

The second of these two lines of lower court opinions abandons any pretext of protecting a line between contract and tort.[197] Instead, these opinions are premised solely on the second rationale of putting limits on negligence cases, by simply prohibiting negligence claims altogether for purely economic losses.[198]

Despite the periodic issuance of these lower court opinions, which sought to expand the economic-loss rule in Texas, over the last decade the Supreme Court continued to reiterate that the purpose of the economic-loss rule is to protect existing contractual relationships.[199] In the four years prior to its *Sharyland* opinion, the Supreme Court addressed the economic-loss rule four times.[200] In each opinion the court consistently defined the economic loss rule as precluding recovery in tort for economic losses resulting from the failure of a party to perform under a contract, with a focus on determining whether the injury is to the subject of the contract itself.[201]

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[193] *Coastal Conduit & Ditching, Inc.*, 29 S.W.3d at 288.

[194] *Id.*

[195] *Express One Int'l, Inc.*, 53 S.W.3d at 899–901.

[196] *Coastal Conduit & Ditching Inc.*, 29 S.W.3d at 287.

[197] *Express One Int'l, Inc.*, 53 S.W.3d at 899.

[198] *Id.*; *see also Coastal Conduit & Ditching Inc.*, 29 S.W.3d at 285–86.

[199] Equistar Chems., L.P. v. Dresser-Rand Co., 240 S.W.3d 864, 867 (Tex. 2007); Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 12–13 (Tex. 2007); Med. City Dallas, Ltd. v. Carlisle Corp., 251 S.W.3d 55, 61 (Tex. 2008); ½ Price Checks Cashed v. United Auto. Ins. Co., 344 S.W.3d 378, 387 (Tex. 2011).

[200] *See* cases cited *supra* note 199.

[201] *Id.*

Ultimately, in *Sharyland*, the court addressed the potential application of the economic loss rule to negligence claims between contractual strangers.[202] While acknowledging that an economic-loss rule can potentially be applied in Texas in the absence of contractual privity, the court points to multiple cases that have allowed a tort recovery for pure economic loss, suggesting that the need for an economic loss rule may be limited when it is not protecting a direct contractual allocation of risks between the parties:

> [W]e have applied the economic loss rule only in cases involving defective products or failure to perform a contract. In both of those situations, we held that the parties' economic losses were more appropriately addressed through statutory warranty actions or common law breach of contract suits than tort claims. Although we applied this rule even to parties not in privity (e.g. a remote manufacturer and a consumer), we have never held that it precludes recovery completely between contractual strangers in a case not involving a defective product—as the court of appeals did here.
>
> The court of appeals relied on a different sort of economic-loss rule—one that says that you can never recover economic damages for a tort claim—to reject Sharyland's negligence claim against the contractors. . . . To say that the economic-loss rule "preclude[s] tort claims between parties who are not in contractual privity" and that damages are recoverable only if they are accompanied by "actual physical injury or property damage," overlooks all of the tort claims for which courts have allowed recovery of economic damages even absent physical injury or property damage.[203]

The court then calls into question the idea of using the economic loss rule for the purpose of protecting a theoretical indirect risk allocation between contractual strangers:

[202] 354 S.W.3d 407, 420 (Tex. 2011).

[203] *Id.* at 418 (citations omitted).

> Moreover, the question is not whether the economic-loss rule should apply where there is no privity of contract (we have already held that it can), but whether it should apply at all in a situation like this. Merely because the sewer was the subject of *a* contract does not mean that a contractual stranger is necessarily barred from suing a contracting party for breach of an independent duty. If that were the case, a party could avoid tort liability to the world simply by entering into a contract with one party. The economic-loss rule does not swallow all claims between contractual and commercial strangers.[204]

And finally, the court squarely acknowledges the issue of the second rationale for the economic-loss rule, as to whether the recovery of purely economic losses should simply be eliminated in all negligence actions, whether privity exists or not:

> The court of appeals' blanket statement also expands the rule, deciding a question we have not—whether purely economic losses may ever be recovered in negligence or strict liability cases. This involves a third formulation of the economic loss rule, one that does not lend itself to easy answers or broad pronouncements.[205]

In other words, the Texas Supreme Court has not endorsed the third category of the economic-loss rule referenced by so many Texas lower courts and federal courts, based on application of the second rationale for the economic-loss rule, and the court is not likely to announce a highly expansive version of the rule to bar recovery of pure economic loss in negligence claims generally. The court certainly finds no need to do so in *Sharyland*.

The *Sharyland* opinion does not answer all questions. It leaves open the question of whether, in an appropriate case, there may be a need to place limits on the reach of a negligence action to prevent unlimited liability for purely economic losses.[206] However, those limits are not likely to take the form of an excessively broad version of the economic loss rule. It is more

[204] *Id.* at 419.

[205] *Id.*

[206] *Id.* at 420.

likely that future pronouncements of the economic-loss rule will focus on one or both of the following:

- Whether the defendant has violated an independent duty, i.e. an established duty existing independently of merely some duty to avoid economic harm to the world at large and independently of a duty arising solely by virtue of a contractual agreement.

- The degree to which harm from violation of the duty was foreseeable to clearly identifiable parties, extending beyond undifferentiated harm merely foreseeable to the public generally.

In fact, the court's holdings regarding economic losses in other types of tort actions provide helpful guidance about these factors.

D. Fraudulent Inducement and Fraud

In the context of fraudulent inducement, the court has allowed recovery of purely economic losses rather than applying an economic-loss rule, based upon the existence of an independent duty owed to a specifically identifiable party.[207]

Generally, the first of the *Reed/DeLanney* factors ("the nature of the plaintiff's injuries") requires that the injury in question be separate and distinct from an injury simply caused by a breach of the contract.[208] In *Formosa Plastics v. Presidio Engineers*, for purposes of fraudulent inducement claims, the Texas Supreme Court ignored this "nature of the injury" factor from the *Reed/DeLanney* criteria, focusing instead on the existence of an independent duty owed to a specifically identifiable party.[209]

Formosa sent Presidio Engineers an invitation to bid on the concrete foundations for a large construction project.[210] The bid invitation contained certain representations about how Formosa would handle the project.[211]

[207] *See, e.g.*, Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 45–46 (Tex. 1998).

[208] *See supra* Part IV for discussion of the *Reed/DeLanney* factors.

[209] *Formosa Plastics Corp. USA*, 960 S.W.2d at 45.

[210] *Id.* at 43.

[211] *Id.*

Presidio relied on these representations in preparing a bid.[212] After Presidio was awarded the contract, the company realized that Formosa's representations in the bid invitation were false.[213] Presidio sued Formosa for fraudulent inducement of the contract, claiming Formosa intentionally made misrepresentations to entice Formosa to make a low bid on the project.[214]

Relying on the *Reed/DeLanney* "nature of the injury" factor, Formosa argued that the fraud claim should be barred because Presidio's injuries were purely economic losses flowing from the subject matter and anticipated performance of the contract.[215] The court, however, declined to apply the economic-loss rule in the presence of a fraudulent inducement of the contract.[216] In essence, for purposes of fraudulent inducement, the court looked to the *Reed/DeLanney* "source of the duty" factor to the exclusion of the "nature of the injury" factor.[217] The court reasoned that the legal duty to avoid fraudulently targeting a party to procure a contract already exists separately and independently of any duties established by the contract itself.[218] Therefore, a plaintiff should still be able to recover tort damages for the fraud without having to prove an injury independent of the subject of the contract (since the injury resulting from a fraudulently induced contract will often be the same injury that would be pursued for breach of contract):

> [T]ort damages are recoverable for a fraudulent inducement claim irrespective of whether the fraudulent representations are later subsumed in a contract or whether the plaintiff only suffers an economic loss related to the subject matter of the contract. Allowing the recovery of fraud damages sounding in tort only when a plaintiff suffers an injury that is distinct from the economic losses recoverable under a breach of contract claim is inconsistent with this well-established law [previously discussed], and also ignores the fact that an independent legal duty, separate from the

[212] *Id.*

[213] *Id.*

[214] *Id.*

[215] *Id.* at 44.

[216] *Id.* at 47.

[217] *Id.* at 45.

[218] *Id.* at 46 ("Texas law has long imposed a duty to abstain from inducing another to enter into a contract through the use of fraudulent misrepresentations.").

> existence of the contract itself, precludes the use of fraud to induce a binding agreement.[219]

There simply was no reason to discard established precedent in favor of an economic loss rule, when the result of doing so would be to leave no remedy for violation of an independent duty against a clearly identifiable party.[220] In the event of pleading and proof of fraudulent inducement of a contract, all resulting damages are recoverable without regard to the economic loss rule, including benefit-of-the-bargain damages based on expectancy under the contract.[221]

The court subsequently clarified that benefit-of-the-bargain damages are not necessarily recoverable for all forms of fraud, despite some language within *Formosa* possibly suggesting that.[222] If a plaintiff is defrauded into relying on an unenforceable agreement, there cannot be a valid claim for fraudulent inducement of a contract when there is no contract, and thus benefit-of-the-bargain damages are not recoverable.[223] Nevertheless, there may still be a valid claim for fraud (as opposed to fraudulent inducement), for which out-of-pocket damages are recoverable.[224]

Of course, both out-of-pocket damages and benefit-of-the-bargain damages are merely different measures for the economic losses flowing from a particular form of fraud.[225] Simply stated, the economic-loss rule is not applicable to bar purely economic losses resulting from true fraud (as opposed to a routine breach-of-contract claim dressed up to parade as fraud).[226] There is a duty that exists independently of contract not to

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[219] *Id.* at 47.

[220] *See id.*

[221] *Id.* at 47. In 2006, in *Tony Gullo Motors I, L.P. v. Chapa*, 212 S.W.3d 299, 306 (Tex. 2006), the Supreme Court again reiterated that, while recognizing the need to keep tort law from overwhelming contract law, "procuring of a contract by fraud" constitutes more than another contract dispute, citing *Formosa*. *See also* Reservoir Sys, Inc. v. TGS-NOPEC Geophysical Co., 335 S.W.3d 297, 308 (Tex.App.—Houston [14th Dist.] 2010, pet. denied) (breach of contract damages recoverable from defendant corporation and fraudulent inducement damages recoverable from president and owner of defendant corporation).

[222] Haase v. Glazner, 62 S.W.3d 795, 798–99 (Tex.2001) (benefit-of-the-bargain recovery not allowed on claim for fraudulent inducement of a contract unenforceable pursuant to Statute of Frauds).

[223] *Id.*

[224] *Id.* at 800.

[225] *See id.*

[226] *Id.* at 799.

defraud another party, and the party or parties who would be injured by a breach of that duty are clearly identifiable and differentiated from the world at large.[227] There is no reason to leave defrauded parties without a remedy for purely economic losses, and to do so would obliterate longstanding precedent in fraud cases.[228]

Numerous appellate decisions have understandably refused to allow a fraud recovery where the plaintiff's allegations of post-contract fraud essentially amount to a breach-of-contract allegation dressed up as a tort claim.[229] Defendants routinely use the *Reed/DeLanney* factors to argue that a post-contract fraud claim is simply a disguised breach-of-contract claim, by showing how the alleged fraudulent misrepresentation would not be a misrepresentation absent contractual duties (no independent duty violated), and by showing that the claimed injury is the same as would exist for a breach of contract claim (no independent injury shown), while arguing that the *Formosa* fraudulent-inducement exception for benefit-of-the-bargain damages should not be applied to post-contract fraud.

For example, the defendant in *D'Lux Movers & Storage v. Fulton* successfully argued that the alleged fraud actually related to performance of the contract and was therefore a disguised breach-of-contract claim.[230] In

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[227] *See id.*

[228] *See* Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.3d 41, 45 (Tex. 1998).

[229] *See, e.g.*, Classical Vacations, Inc. v. Air Fr., No. 01-01-01137-CV, 2003 WL 1848247, *3 (Tex. App.—Houston [1st Dist.] April 10, 2003, no pet.) (damages may be recovered for fraudulent inducement that are the same as breach-of-contract damages, but economic-loss rule bars recovery for the same damages on allegations of post-contract fraud); Hooker v. Nguyen, No. 14-04-00238-CV, 2005 WL 2675018, *6–7 (Tex. App.—Houston [14th Dist.] Oct. 20, 2005, pet. denied) (mem. op.) (refusing to extend exception to the independent injury rule from *Formosa* to fraud that occurs after the formation of a contract); Heil Co. v. Polar Corp., 191 S.W.3d 805, 816–17 (Tex. App.—Fort Worth 2006, pet. denied) (stating that exception to independent injury rule from *Formosa* only applies to fraudulent inducement claims and not fraud generally); Exxon Mobil Corp. v. Gill, 221 S.W.3d 841, 848–49 (Tex. App.—Corpus Christi 2007), *rev'd on other grounds*, 299 S.W.3d 124 (Tex. 2010) (explaining that claims by service station dealers that Exxon cheated dealers out of economic benefit of rebates under sales agreement are economic losses under the contract with Exxon and not fraud); Hameed Agencies (pvt) Ltd. v. J.C. Penney Purchasing Corp., No. 11-05-00140-CV, 2007 WL 431339, at *5–6 (Tex.App.—Eastland Feb. 8, 2007, pet. denied) (mem. op.) (holding that after execution of a contract, plaintiff's claim of being fraudulently induced into not exercising agreement's ninety-day termination clause, held to be a breach-of-contract claim and not supportable as fraud under economic loss rule).

[230] No. 2-06-019-CV, 2007 WL 1299400, at *2–3 (Tex. App.—Fort Worth May 3, 2007, pet. denied) (mem. op.); *see also Hameed*, 2007 WL 431339, at *5.

that case, a moving company contracted with plaintiffs to crate and ship two glass table tops.[231] The moving company failed to crate the table tops as agreed, and one of the table tops broke.[232] Plaintiffs claimed the moving company fraudulently induced them post-contract to forego purchasing insurance on the table tops.[233] The court held that the moving company's representations about the agreement may have induced the plaintiffs to forego insurance, but it did not fraudulently induce the plaintiffs to enter into the moving contract.[234] The moving company's duty and liability arose solely from the contract, and therefore the plaintiffs could not recover tort damages.[235]

Conversely, in *Cass v. Stephens*, the El Paso Court of Appeals characterized a fraudulent double-billing under a contract as a fraudulent inducement to pay for goods and services that were never received.[236] The court's analysis utilizes the framework of the *Reed/DeLanney* factors and the authority of the *Formosa* fraudulent-inducement exception:

> First, we consider whether Frank's conduct breached an obligation at law or in contract. In this case, the [agreements] authorized Frank to bill the joint interest owners for certain expenses incurred in operating the jointly held leases. The agreements did not authorize Frank to bill the joint accounts for expenses incurred on the Cass companion wells, or to double-bill for equipment already owned by the joint accounts. We conclude that Frank breached a duty imposed by law when he fraudulently induced the joint interest owners to pay for goods and services they never received. Specifically, Frank induced the joint interest owners to pay for the goods and services by submitting bills that intentionally misrepresented that they were authorized by the agreements. *Thus, the agreements created a conduit for committing the torts, but the duty breached exists independent from the agreements.*

[231] *D'Lux Movers & Storage*, 2007 WL 1299400, at *1.

[232] *Id.*

[233] *Id.* at *2.

[234] *Id.* at *3.

[235] *Id.*

[236] 156 S.W.3d 38, 69 (Tex. App.—El Paso 2004, pet. denied).

> Second, we consider the nature of the injury. Here, the subject matter of the agreements is the operation of the jointly-owned wells. To the extent that Stephens was billed for goods and services that went to the Cass companion wells, her damages relate to charges that are independent of the [agreements]. In addition, we reject the contention that Stephens' injury is contractual because she recovered economic damages. Frank's fraud caused the joint interest owners to pay for goods and services they never received. Logically, their damages are economic—fraudulently induced payment of money results in money damages. We conclude that the injury is tortious in nature.[237]

This analysis makes sense. It is one thing to breach a contract through nonfeasance. However, when a party engages in deception of a nature sufficient to support the heightened findings required for fraud, that party should not be entitled to then rely on an economic loss rule to bar recovery if and when caught.[238] No one should be encouraged to engage in fraud by creating a win-win scenario for the tortfeasor, that is: if the fraud is successful, no one knows; and if the fraud is detected and proved, the defrauding party can still rely on contractual limitations and avoid payment of economic damages in fraud.[239]

Even less justification exists for applying the economic loss rule to a fraud claim in the *absence* of a contractual relationship. If the fraud claim *does not* arise from a contractual relationship, the only duty being breached is the duty to avoid committing fraud.[240] And because fraud is an

[237] *Id.* at 68–69 (emphasis added) (citing Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 45–46 (Tex. 1998)). For a similar analysis of Texas law allowing a post-contract fraud claim to proceed and denying application of the economic-loss rule/independent injury rule, *see* Regus Mgmt. Grp., LLC, v. Int'l Bus. Mach. Corp., No. 3:07-CV-1799-B, 2008 WL 1836360, at *7 (N.D. Tex. Apr. 24, 2008) (denying 12(b)(6) motion to dismiss plaintiff's post-contract fraud claim on basis of economic loss rule); *see also* Experian Info. Solutions, Inc. v. Lexington Allen L.P., No. 4:10-CV-144, 2011 WL 1627115, at *12 (E.D.Tex. Apr. 7, 2011) (economic loss rule does not bar post-contract fraud at issue in case, whether characterized as fraudulent inducement outside the contract, fraudulent misrepresentation, fraudulent inducement to continue performance, or fraud in the performance); Paradigm Oil, Inc. v. Retamco Operating, Inc., 330 S.W.3d 342, 353–55 (Tex. App.—San Antonio 2010, pet. filed) (economic loss rule bar held not to bar recovery of economic damages for post-contract fraud).

[238] *See Cass*, 156 S.W.3d at 68–69.

[239] *See id.*

[240] *See Formosa Plastics Corp. USA*, 960 S.W.2d at 45–46 (Tex. 1998).

intentional tort targeted at one or more identifiable parties, the second rationale for the economic loss rule (to prevent unlimited liability) does not come into play. When financial injury occurs as the result of fraud occurring outside of contract, clearly there is no sound rationale for applying the economic loss rule in order to bar recovery of the economic loss.[241]

F. Negligent Misrepresentation

Negligent misrepresentation does not require contractual privity, but neither is it broadly applied to allow a claim against any defendant whose statement has unintentionally misled another.[242] Liability depends on proving the requirements of the *Restatement (Second) of Torts* Section 552, which limits a defendant to someone who, in the course of a business, profession or employment, or in any other transaction in which he has a pecuniary interest, has supplied false information for the guidance of others in their business transactions.[243] Plaintiff status is limited to persons for whose benefit and guidance the defendant intended to supply the information, for a transaction the defendant intended the information to influence.[244]

When these requirements are met, a plaintiff is permitted—pursuant to the *Restatement (Second) of Torts* Section 552—to recover economic out-of-pocket losses, but not benefit-of-the-bargain damages (which would require the more extensive proof required for fraudulent inducement).[245] By limiting recovery to out-of-pocket economic damages rather than

[241] *See, e.g.*, Medistar Twelve Oaks Partners, Ltd. v. Am. Econ. Ins. Co., No. H-09-3828, 2010 WL 1996596, at *7, *12 (S.D. Tex. May 17, 2010) (concluding that the economic loss rule does not apply to a fraud claim against a party with whom there is no contract, after stating in dicta that an economic loss fraud claim against a party in contractual privity would be barred by the economic-loss rule).

[242] *See* McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787, 795 (Tex. 1999); *see also* Martin K. Eby Const. Co. v. LAN/STV, 350 S.W.3d 675, 688 (Tex. App.—Dallas 2011, pet. filed) (showing that a design professional for construction project can be held responsible by contractor for negligent misrepresentation despite lack of privity); CCE, Inc. v. PBS & J Const. Servs, Inc., No. 01-09-00040-CV, 2011 WL 345900, at *7–8 (Tex. App.—Houston [1st Dist.] Jan. 28, 2011, pet. filed) (explaining that negligent misrepresentation claim for professional engineering plans).

[243] RESTATEMENT (SECOND) OF TORTS § 552 (1977).

[244] *CCE*, 2011 WL 3459000, at *4.

[245] D.S.A., Inc. v. Hillsboro I.S.D., 973 S.W.2d 662, 663–64 (Tex. 1998).

benefit-of-the-bargain economic damages, the court is continuing to protect the boundary between contract and tort, staying true to the first rationale for the economic-loss rule.[246] The court is electing to do so, however, by following the guidance of the *Restatement (Second) of Torts* for negligent misrepresentation, rather than announcing a formulaic application of the economic loss rule to bar recovery of all negligently-caused pure economic damages.[247] As in the case of *DeWitt County Electric Cooperative, Inc. v. Parks*, the Supreme Court in *D.S.A., Inc. v. Hillsboro Independent School District* appears more focused on a fair and effective preservation of the line between contract and torts, instead of a rigid adherence to an "economic loss rule" that is not really a rule.[248]

This means that the burden is on the plaintiff to demonstrate an injury independent from the benefit-of-the-bargain damages which would be available for breach of contract.[249]

In *D.S.A.*, a construction management firm supervised the building of a school.[250] The school district subsequently sued the management firm after spending more than $220,000 to correct defects from the construction, alleging breach of contract, negligent and grossly negligent misrepresentation, and Texas Deceptive Trade Practices Act (DTPA) violations.[251] Specifically with regard to the claim of negligent misrepresentation, the plaintiff alleged that the defendant had negligently misrepresented the supervisory functions it would perform.[252] The defendant argued that the independent injury rule should bar the negligent misrepresentation claim because the claim was only for economic loss arising out of the subject of the contract.[253] The plaintiff school district, on the other hand, sought to apply the rationale of the *Formosa* case, arguing

[246] *See id.* at 664.

[247] *See id.*

[248] *See* DeWitt Cnty. Elec. Co-op., Inc. v. Parks, 1 S.W.3d 96, 105 (Tex. 1999); *see also D.S.A.*, 973 S.W.2d at 663–64.

[249] *D.S.A.*, 973 S.W.2d at 663–64; *see also* Sterling Chems, Inc. v. Texaco Inc., 259 S.W.3d 793, 797 (Tex. App.—Houston [1st Dist.] 2007, pet. denied); Robert K. Wise & Heather E. Poole, *Negligent Misrepresentation in Texas: The Misunderstood Tort*, 40 Tex. Tech L. Rev. 845, 902–04 (2008).

[250] 973 S.W.2d at 663.

[251] *Id.*

[252] *Id.*

[253] *Id.* The opinion does not specifically refer by name to the "economic-loss rule." Instead, it speaks of the lack of any "independent injury" separate from the contract. *Id. See* discussion *infra* Part I.C.

that there is an independent duty not to negligently misrepresent facts in conjunction with a contract negotiation, just like there is an independent duty not to fraudulently induce another party into a contract, and therefore there should be no need to demonstrate an independent injury.[254]

The Supreme Court declined to extend the *Formosa* exception for independent injury to this situation.[255] The court held the school's negligent misrepresentation claim to be barred because the plaintiff had failed to demonstrate any injury independent of contract damages.[256] The court explains that it treats fraudulent inducement differently from negligent misrepresentation because negligent misrepresentation implicates only a duty of care in supplying commercial information, and "repudiating the independent injury requirement . . . would potentially convert every contract interpretation dispute into a negligent misrepresentation claim."[257]

In a generalized way, the court's treatment of negligent misrepresentation is possibly suggestive regarding how it may choose to handle questions of privity, foreseeability, and the economic loss rule in negligence cases generally, when confronted with the argument that negligence claims for economic loss can result in unlimited liability. Privity should not be the issue, just as it is not the issue in negligent misrepresentation. And rather than applying a needlessly overbroad economic loss rule to bar recovery of all pure economic loss claims in negligence simply to avoid grappling with the issue of expansive foreseeability (an approach which the court has already appeared to reject in *Sharyland*), presumably the court will instead be looking for more narrowly-defined duties than a duty owed to the world at large to avoid economic harm (such as the independent duty of the defendant contractor in *Sharyland* to keep sewer lines sufficiently distanced from water lines), and possibly for damages tied more closely to plaintiffs' out-of-pocket losses rather than to lost profits (benefit-of-the-bargain damages).

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[254] *D.S.A., Inc.*, 973 S.W.2d at 663.

[255] *Id.*

[256] *Id.* ("The *Formosa* opinion's rejection of the independent injury requirement in fraudulent inducement claims does not extend to claims for negligent misrepresentation or negligent inducement.").

[257] *Id.* at 664.

G. DTPA Claims

Many attorneys attempt to mold a breach of contract claim into a claim for relief under the DTPA because, unlike breach of contract, the DTPA allows a plaintiff to recover both economic damages and discretionary damages for a knowing or intentional violation of the Act.[258] A plaintiff, however, must still consider the *Reed/Delanney* factors in addressing whether a cause of action arising out of a contractual relationship may successfully be brought under the DTPA. As is true with a negligence claim, the court will consider the nature of the plaintiff's injury and the source of the defendant's duty in determining whether a claim properly should be brought for breach of contract or for a violation of the DTPA.[259]

Generally, a simple breach of contract, without more, will not be a violation of the DTPA.[260] For example, in *Crawford v. Ace Sign*, the plaintiff sued the defendants for breach of contract, negligence, and violations of the DTPA for failing to include a yellow page advertisement in the phone book.[261] The negligence action failed because the defendants' source of duty and liability arose solely from the contract, and because the source of the plaintiff's economic loss arose solely from the contract.[262] For the DTPA action, the plaintiff attempted to prove that the defendant had made several representations during the negotiation of the contract that were false, misleading or deceptive.[263] These representations included promising the plaintiff the ad would be published upon payment and that a yellow page ad would increase the plaintiff's business.[264] The Texas Supreme Court held that these statements were nothing more than representations that the defendants would fulfill their contractual duties.[265] "The *statements* themselves did not cause any harm;" it was the failure to publish the ad that caused the injury.[266] The court looked at the nature of the plaintiff's injury to determine whether the cause of action arose from the

[258] TEX. BUS. & COM. CODE § 17.50(b) (West 2011).

[259] *See* TEX. BUS. & COM. CODE § 17.50(a) for a complete list of causes of action under the DTPA. In addition to addressing the *Reed/DeLanney* factors, a plaintiff must prove he or she is a "consumer" under the DTPA and that the defendant violated a provision of the DTPA. *Id.*

[260] Ashford Dev., Inc. v. USLife Real Estate Serv., 661 S.W.2d 933, 935 (Tex. 1983).

[261] 917 S.W.2d 12, 12 (Tex. 1996) (per curiam).

[262] *Id.* at 13.

[263] *Id.* at 14.

[264] *Id.*

[265] *Id.*

[266] *Id.* at 14–15.

contract or the DTPA violations.[267] Here, the nature of the plaintiff's injury flowed from the breach of the contract and not the statements the plaintiff alleged to be in violation of the DTPA; therefore, the applicable cause of action was breach of contract.[268]

The results of this analysis will obviously differ from case to case. In another Texas Supreme Court opinion, *Tony Gullo Motors I, L.P. v. Chapa*, the court acknowledged that, under the facts of that case, economic damages could be recovered for either breach of contract or pursuant to the DTPA.[269]

H. The Interplay Between Contract and Other Torts

Absent a special relationship, even an intentional breach of a contract is still not a tort. For example, in *Janicek v. Kikk Inc.*, the plaintiff accused the defendant of intentionally breaching the contract and claimed that the defendant's conduct was "haughty" and "reckless."[270] Whether a defendant accidentally breaches a contract or makes a conscious decision to breach, the cause of action for nonfeasance under the contract is still plain-vanilla breach of contract.[271]

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[267] *Id.* at 13–14.

[268] *Id.*

[269] 212 S.W.3d 299, 304–06 (Tex. 2006). Two cases provide useful examples of plaintiffs meeting the requirements for maintaining DTPA actions over objections that only contractual duties were implicated. In *Cimarron Hydrocarbons Corp. v. Carpenter*, 143 S.W.3d 560, 561 (Tex. App.—Dallas 2004, pet. denied), the trial court granted a no-evidence summary judgment in favor of the owner/operator of the company who was sued in his individual capacity for negligence, violations of the DTPA, and misrepresentation. The court of appeals reversed, holding a corporate agent is liable for his own tortious acts, including violations of the DTPA. *See id.* at 565. In *Dallas Fire Ins. Co. v. Tex. Contractors Sur. & Cas. Agency*, 128 S.W.3d 279, 294 (Tex. App.—Fort Worth 2004), *rev'd on other grounds*, 159 S.W.3d 895 (Tex. 2004), the appellate court held that *Formosa's* exception to the independent injury rule applies to claims of knowing misrepresentation under the DTPA. Conversely, relying on *D.S.A., Inc. v. Hillsboro I.S.D.*, 973 S.W.2d 662, 663 (Tex. 1998), the court did not extend the independent injury exception to *negligent* misrepresentation claims under the DTPA. *See Dallas*, 128 S.W.3d at 294 n.45. The court of appeals held the plaintiff's knowing misrepresentation claims were not based on the defendant's failure to perform duties imposed by the contract but rather on the independent duty imposed by the law to not make knowing misrepresentations inducing a party into a contract. *See id.* at 294.

[270] 853 S.W.2d 780, 782 (Tex. App.—Houston [14th Dist] 1993, writ denied).

[271] *Id.*

However, for situations in which the complaint is something other than of a failure of a party to the contract to comply with contractual terms, to what extent may the economic loss rule be invoked to bar intentional torts?

The Texas Supreme Court in *Formosa* referenced its prior holding allowing recovery of economic loss for tortious interference with contract without the necessity of showing an independent injury differing from breach of contract:

> Since *Graham*, this Court has continued to recognize the propriety of fraud claims sounding in tort despite the fact that the aggrieved party's losses were only economic losses. Moreover, we have held in a similar context that tort damages were not precluded for a tortious interference with contract claim, notwithstanding the fact that the damages for the tort claim compensated for the same economic losses that were recoverable under a breach of contract claim.[272]

Refusing to apply the economic loss rule to tortious interference with contract makes sense. An intentional tort like tortious interference often causes economic loss as its sole result, and the duty to refrain from this kind of intentional tort is created by law, not by contract.[273] To eviscerate enforcement of a remedy for an intentional tort of this sort simply because it causes economic loss would only serve the interest of intentional tortfeasors.

The intentional tort of conversion poses a somewhat different question. Depending on the case, the line between lawful possession and conversion may be dependent on the existence and interpretation of a contract. In that situation, application of the economic loss rule as a bar to the tort action may be justified. On the other hand, it is not justifiable to eliminate tort recovery for economic loss in a conversion action that is maintained between parties who have no contractual relationship. Again, to apply the

[272] Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 47 (Tex. 1998) (citations omitted). *See also* Access Telecomm, Inc. v. MCI Telecomm. Corp., 197 F.3d 694, 711–12 (5th Cir. 1999) (applying Texas law, the economic-loss rule does not bar a tortious interference claim, reasoning that the duty to avoid tortious interference exists independently of any contractual duty; the fact that the economic loss itself is measured by the contract and therefore does not constitute an independent injury not matter).

[273] *See, e.g.*, Anderson, Greenwood & Co. v. Martin, 44 S.W.3d 200, 219 (Tex. App.—Houston [14th Dist.] 2001, pet. denied).

bar of the economic loss rule in that situation would only serve the interest of the intentional tortfeasor.

As would be expected, courts have treated conversion actions differently based on the fact situation presented. In some situations, courts have held conversion actions to be independent of contract and therefore maintainable as a tort action despite allegations that the conversion occurred in the context of a contractual relationship.[274] In other cases, courts have applied the economic loss rule to bar the tort action.[275]

The Tyler Court of Appeals refused, in *Castle Texas Production Ltd. Partnership v. Long Trusts*, to extend *Formosa's* fraudulent inducement exception for the independent injury rule to conversion claims.[276] The court held the plaintiff's loss was entirely economic loss to the subject matter of the contract; therefore, plaintiff was not entitled to recover in tort on a conversion claim.[277] A similar result was reached in *Exxon Mobil Corp. v. Kinder Morgan Operating L.P.*[278] There the court held that the conversion claim related to the subject of the contract and involved duties which were detailed in the contract, and thus the claim sounded only in contract.[279] And in *Dhanani v. Giles*, an action for conversion was denied after the seller retained a $10,000 down payment pursuant to a contractual relationship (although credit for that amount was allowed by the court on another cause of action); a conversion action was not needed.[280]

The case of *Cass v. Stephens* produced a different result.[281] The court held that the plaintiff's cause of action for conversion could be asserted in tort when defendant used jointly-owned equipment for the benefit of wells owned solely by the defendant.[282] The court reasoned that the defendant breached an obligation independent of the joint operating agreement, and the injury flowed from the misappropriation of the equipment and the deception regarding the equipment transfers, rather than from the

[274] *See, e.g.*, Cass v. Stephens, 156 S.W.3d 38, 69 (Tex. App.—El Paso 2004, pet. denied).

[275] *See, e.g.*, Castle Tex. Prod. L.P. v. Long Trusts, 134 S.W.3d 267, 275 (Tex. App.—Tyler 2003, pet. denied); *In re* Soporex, Inc., 446 B.R. 750, 788 (Bankr. N.D. Tex. 2011).

[276] 134 S.W.3d at 273–74.

[277] *Id.* at 275.

[278] 192 S.W.3d 120, 128 (Tex. App.—Houston [14th Dist.] 2006, no pet.).

[279] *Id.*

[280] No. 10-07-00144-CV, 2008 WL 2210004, at *4 (Tex. App.—Waco May 28, 2008, pet. denied) (mem. op.).

[281] 156 S.W.3d 38, 69 (Tex. App.—El Paso 2004, pet. denied).

[282] *Id.*

defendant's contractual duty to honestly account for the movement of the equipment.[283]

These opinions are not necessarily inconsistent. Violation of a duty that only exists because the duty has been created by the contract does not subject a defendant to a tort action, only to a contract action, as held in the *Castle*, *Exxon*, and *Dhanani* cases.[284] On the other hand, a tort remedy is consistent with pleading and proof of a duty that exists independently of a contract (e.g., the duty not to convert jointly-owned equipment for personal gain).[285] These opinions highlight the importance of carefully and deliberately framing the argument during pleading and discovery in light of the *Reed/DeLanney* "nature of the injury"/"source of the duty" factors.

I. Exception for Physical Injury to Person or Property

Tort claims for economic loss which might otherwise be barred by the economic loss rule, including both strict liability and negligence claims, are allowed if there is a showing of physical injury to the person or other property of the plaintiff.[286] The reasoning behind this exception is the recognition (as expressed in numerous cases starting with the seminal *Seely*)[287] that physical injury is best addressed in tort rather than contract, with contract and warranty remedies best reserved for economic losses.[288]

For example, in *Strakos v. Gehring*, the Texas Supreme Court acknowledged that a subcontractor who created an unsafe condition potentially faced liability to the injured employees of another subcontractor even after the work had been accepted contractually.[289] The court rejected the defense that a general contractor's acceptance of defective work contractually shielded the subcontractor from liability.[290] The court analogized the situation to a manufacturer's liability to a third-party purchaser.[291]

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[283] *Id.*

[284] *See* Castle Tex. Prod. L.P. v. Long Trusts, 134 S.W.3d 267, 275 (Tex. App.—Tyler 2003, pet. denied); *Exxon Mobil Corp*., 192 S.W.3d at 128; *Dhanani*, 2008 WL 2210004, at *4.

[285] *See Cass*, 156 S.W.3d at 69.

[286] Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965).

[287] *Id.*

[288] *Id.* at 151–52.

[289] 360 S.W.2d 787, 790 (Tex. 1962).

[290] *Id.*

[291] *Id.* at 789–90.

The Austin Court of Appeals applied this reasoning to hold a washing machine repair company liable for the injuries that a hotel employee suffered while using the washing machine.[292] The repair company contracted only with the hotel, but the court held that "[t]his duty extended to [the employee] as one using the machine even though she was not a party to the . . . contract."[293] The Houston Court of Appeals for the Fourteenth District in *Wolf Hollow I, L.P. v. El Paso Marketing, L.P.* held that a duty (to deliver natural gas) arising only by virtue of a contract does not result in a negligence claim being barred by the economic-loss rule when contaminated gas has caused injury to the plaintiff's equipment.[294] The Texarkana Court of Appeals reached a similar conclusion in *Goose Creek Consolidated Independent School District v. Jarrar's Plumbing, Inc*.[295]

Likewise, in a strict liability products case seeking economic loss, the plaintiff must demonstrate physical injury to his person or other property, because the economic loss rule bars tort recovery when damages are limited to the product itself.[296] For injury to plaintiff's person or "other property," a plaintiff may recover tort damages including the resulting economic loss.[297] However, in the situation of damage to the product only, the plaintiff is limited to breach of warranty claims under the UCC.[298]

This naturally produces questions, including:

- What is the distinction between physical injury to "other property" versus only economic loss to other property?

[292] Byrd v. Skyline Equip. Co., 792 S.W.2d 195, 197 (Tex. App.—Austin 1990, writ denied).

[293] *Id.*

[294] 329 S.W.3d 628, 645 (Tex. App.—Houston [14th Dist.] 2010, pet. filed).

[295] 74 S.W.3d 486, 494–95 (Tex. App.—Texarkana 2002, pet. denied) (holding that economic loss rule which would otherwise be applicable in suit between school district and plumbing subcontractor without contractual privity was inapplicable because of raw sewage actually invading school property).

[296] Nobility Homes of Tex. v. Shivers, 557 S.W.2d 77, 80 (Tex. 1977); Mid Continent Aircraft Corp. v. Curry Cnty. Spraying Servs., 572 S.W.2d 308, 313 (Tex. 1978).

[297] Equistar Chems., L.P. v. Dresser-Rand Co., 240 S.W.3d 864, 867 (Tex. 2007) ("The rule does not preclude tort recovery if a defective product causes physical harm to the ultimate user or consumer or other property of the user or consumer in addition to causing damage to the product itself.").

[298] *Mid Continent Aircraft Corp.*, 572 S.W.2d at 313.

- Does injury to the person or property of someone other than the plaintiff suffice to allow recovery of the plaintiff's economic loss?

- When there is damage to "other property," may economic loss for injury to the defective product also be recovered?

- When a component part causes damage to the larger finished product in which it is contained, does that constitute damage to "other property" sufficient to prevent operation of the economic loss rule?

1. Distinction Between Physical Injury to Other Property Versus Only Economic Loss to Other Property

How is the distinction made between physical injury to other property versus only economic loss to other property? As an example, when asbestos must be removed from a building in order to avoid physical injury and to make the building safe and useable, is the cost of that removal strictly an economic loss barred by the economic loss rule? Most courts across the United States "have not considered the cost of removing the material from buildings an economic loss, because the product renders the building (other property) unusable. . . . On the other hand, 'economic loss would include the cost of the product, and the loss of income or profits resulting from the loss of or inability to use the product as intended.'"[299]

The Texas Supreme Court squarely confronts this issue in its new *Sharyland* opinion.[300] In that case, the plaintiff water supply company contended that city sewer lines had been negligently placed on top of company water lines in violation of the law by city subcontractors.[301] The question was whether there had been injury to other property of the plaintiff that prevented application of the economic loss rule.[302]

The plaintiff water supply company sought damages for "increased costs in operation," "costs to place barriers to mitigate the hazard caused by

[299] Chevron USA, Inc. v. Aker Mar., Inc., 604 F.3d 888, 900–01 (5th Cir. 2010) (holding that failure of bolts requiring repairs to spar constitutes damage to "other property" and therefore does not constitute economic loss).

[300] Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407 (Tex. 2011).

[301] *Id.* at 410.

[302] *Id.* at 415–20.

the defendants," and "costs associated with increased safety precaution and maintenance measures it takes when repairing its lines."[303] The jury was instructed to consider only "[t]he reasonable cost of the repairs necessary to restore the property to its condition immediately before the injury."[304]

The plaintiff contended that it was seeking recovery for property damage to its waterlines, not economic loss.[305] Specifically, the plaintiff claimed that its waterlines were threatened by raw sewage potentially leaking from the sewer lines placed above the waterlines; this necessitated action to protect its waterlines from the sewage and to repair them in order to bring them back into compliance with state laws and regulations and to avoid potential injury or death to customers using the water.[306] Therefore, the plaintiff argued that its property had been physically damaged.[307]

In its analysis of this issue, the Corpus Christi Court of Appeals concluded:

> [I]t is clear that property damage cannot consist merely of damage to an intangible asset or increased operational costs. Instead, some physical destruction of tangible property must occur. Based on this determination, we conclude that Sharyland has not suffered property damage. The sewer service lines have not corroded the waterlines. There is no evidence of physical damage to the waterlines, nor is there evidence that the water flowing through the water mains has been contaminated because of sewage leaks. Thus, Sharyland neither pleaded nor offered evidence of an actual injury or property damage to its waterlines or to the water that flows through the waterlines. Sharyland seeks compensation only for economic damages including the cost associated with protecting, maintaining, and repairing its waterlines. Because Sharyland has not identified any property damage that it has sustained as a result of the sewer line being laid above its waterlines, we conclude that the economic loss rule bars Sharyland's

[303] City of Alton v. Sharyland Water Supply Corp., *aff'd in part, rev'd in part*, 277 S.W.3d 132, 146 (Tex. App.—Corpus Christi 2009), 354 S.W.3d 407 (Tex. 2011).

[304] *Id.*

[305] *Id.* at 153.

[306] *Id.*

[307] *Id.*

> negligence claim against C & B, TCB, and Cris, parties with which it is not in contractual privity.[308]

Plaintiff Sharyland Water Supply Corporation appealed to the Texas Supreme Court, and in the process posed an important policy question: Should unlawful encroachment by sewage lines which threatens public health and requires repair costs constitute property damage, or may the economic loss rule be utilized to prevent any remedy until actual contamination or injury occurs?

The Supreme Court reversed on the question of whether physical injury to the plaintiff's property had occurred. The court holds:

> [T]he court of appeals erred in concluding that Sharyland's water system had not been damaged. Sharyland's system once complied with the law, and now it does not. Sharyland is contractually obligated to maintain the system in accordance with state law and must either relocate or encase its water lines. These expenses, imposed on Sharyland by the contractors' conduct, were the damages the jury awarded. Costs of repair necessarily imply that the system was damaged, and that was the case here. Sharyland presented evidence that it experiences between 100 and 150 water system leaks each year. A break in the water line threatens contamination. There was evidence that when Sharyland excavated a representative sample of sixty-six sewer crossings, sixty of them had been illegally installed, and there was at least one leaking sewer pipe located six inches above a water pipe. There was also evidence that approximately 340 locations would require remediation. We disagree that the economic loss rule bars Sharyland's recovery in this case.[309]

From this, it appears that a showing of physical injury does *not* necessarily require physical destruction of property.[310] A demonstration of need to physically repair property, particularly to prevent further threat to persons or property, would appear to suffice as evidence of physical injury

[308] *Id.* at 154–55.

[309] Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 420 (Tex. 2011).

[310] *See id.*

sufficient to defeat application of the economic loss rule.[311] Likewise, by analogy, a need to terminate the use of property because the repair costs exceed the value of the property or are otherwise not feasible would presumably demonstrate the existence of physical injury.

2. Requirement of Physical Injury to the Person or Property of the Plaintiff

Must the physical injury be to the person or property of the plaintiff? Or does injury to the person or property of someone other than the plaintiff suffice to allow recovery of the plaintiff's economic loss?

This question is addressed in *American Eagle Insurance Co. v. United Technology Corp.*,[312] in which the U.S. Court of Appeals for the Fifth Circuit cites to the Texas Supreme Court opinion of *Signal Oil & Gas Co. v. Universal Oil Products*:

> [Plaintiffs] further argue that damage to the ground where the aircraft crashed constitutes "other property," allowing recovery under a strict product liability theory. . . . [Defendants] correctly counter that the damage at the crash site must be damage to [plaintiffs'] "other property." Here, the ground damage occurred to a third-party's property for which the [plaintiffs] subsequently became legally responsible. In *Signal Oil & Gas Co. v. Universal Oil Prods.*, the Texas Supreme Court emphasized that the damage to "other property" must be to the plaintiff's property to state a claim for strict product liability: "One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to *his property* is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to *his property* . . . ." (emphasis in original). [Plaintiffs] admitted that [they] owned no property, other than the aircraft, that was damaged as a result of the crash. Thus, the district court properly granted summary judgment on [Plaintiffs'] strict product liability claim.[313]

[311] *See id.*

[312] 48 F.3d 142, 145 (5th Cir. 1995).

[313] *Id.* at 145 (quoting Signal Oil & Gas Co. v. Universal Oil Prods., 572 S.W.2d 320, 325

3. No Recovery for Economic Loss of Defective Product Despite Loss to Other Property

What happens to a plaintiff's cause of action when a product or the subject of a contract fails and causes loss to not only the product itself or the subject of the contract, but to other property or persons also; is loss to the product or subject of the contract then recoverable along with injury to other property or persons?

This question of recoverability of economic loss to the defective product itself was addressed by the Houston Court of Appeals for the Fourteenth District in a 2003 opinion authored by Justice Scott Brister.[314] Although the opinion in *Equistar Chemicals, L.P. v. Dresser-Rand Co.* was subsequently reversed by the Texas Supreme Court, the Supreme Court did not reach this specific ground.[315]

In the opinion of the court of appeals, damage to other property beyond the defective product itself should be compensable in tort; however, damage to other property does not thereby open up the potential for obtaining recovery for the product itself in tort.[316] The court of appeals cites authority from the U.S. Supreme Court in support of its analysis,[317] and notes that a contrary rule would negate the bargained-for warranties of the parties by opening up recovery in tort if a single paper clip (i.e., other property) goes down with the ship.[318]

Over the past several years, similar analyses appear in other opinions by courts of appeals, although the issue has not necessarily been the direct issue in each case.

In 2003, the Dallas Court of Appeals considered the issue in *Murray v. Ford Motor Co.*[319] When the plaintiff's Ford pickup truck caught fire, there was resulting damage to the truck itself as well as to $453.25 worth of personal property in the truck at the time of the fire.[320] The plaintiff alleged

(Tex. 1978)).

[314] Equistar Chems., L.P. v. Dresser-Rand Co., 123 S.W.3d 584 (Tex. App.—Houston [14th Dist.] 2003), *rev'd*, 240 S.W.3d 864 (Tex. 2007).

[315] Equistar Chems., L.P. v. Dresser-Rand Co., 240 S.W.3d 864 (Tex. 2007).

[316] *Equistar Chems.*, 123 S.W.3d at 586–87.

[317] *Id.* at 587 (citing Saratoga Fishing Co. v. J.M. Martinac & Co., 520 U.S. 875, 882–83 (1997)).

[318] *Id.* at 591.

[319] 97 S.W.3d 888, 893 (Tex. App.—Dallas 2003, no pet.).

[320] *Id.* at 890.

that the fire was the result of an electrical problem in the main wiring harness, bringing causes of action in strict liability and negligence for both the truck and the personal property in the truck.[321]

In its discussion of the economic loss rule, the Dallas Court of Appeals stated that damage to the product itself is "essentially" a loss to the buyer of the benefit of the bargain, equating to damages of loss of use and cost of repair, and that this is to be distinguished from loss of personal or other property.[322] The plaintiff's specific argument to the court was "the economic loss doctrine does not bar recovery in tort for the loss of the truck because there was loss to other property as well as injury to the product itself."[323] The court discussed *Signal Oil & Gas Co. v. Universal Oil Products*, which contains dicta raising the possibility that damage occurring to both the product and other property will allow recovery in tort and that damages for the subject of the contract would be considered property damages instead of economic loss.[324] However, the Dallas court dismissed this language because it was not essential to the actual holding in *Signal Oil*.[325] The Dallas Court of Appeals pointed out the lack of a cited case in which a plaintiff recovered for the loss of the product itself in tort, as opposed to recovering in tort for the loss sustained to other property, and noted that allowing a plaintiff to recover for loss to the defective item in tort has been rejected by the U.S. Supreme Court and Fifth Circuit Court of Appeals.[326] Damages for the loss of the subject of the contract (i.e., the truck) could only sound in contract, whereas damages to "other property" could be brought in a separate tort cause of action.[327] The case therefore required a separation of damages.[328]

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[321] *Id.*

[322] *Id.* at 891.

[323] *Id.* at 892.

[324] 572 S.W.2d 320, 325 (Tex. 1978).

[325] *Murray*, 97 S.W.3d at 892.

[326] *Id.* at 893 (citing E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 875–76 (1986)); *see also* Pugh v. Gen. Terrazzo Supplies, Inc., 243 S.W.3d 84, 92 (Tex. App.—Houston [1st Dist.] 2007, pet denied) ("Texas courts have rejected the argument that damage to a finished product caused by a defective component part constitutes damage to 'other property' so as to permit tort recovery for damage to the finished product.").

[327] *Id.* at 893.

[328] *Id.*

4. Component Part Does Not Qualify Larger Whole as Other Property

What is the result under the economic loss rule if the product or the subject of the contract is defined solely as a component part of the finished product or overall project; does injury to the finished product or remainder of the project become compensable in tort?

The previously discussed *Equistar* opinion of the Houston Court of Appeals for the Fourteenth District also addressed and rejected the possibility of a single component part being identified as the product in question, and thereby opening up a tort recovery for the rest of the project, at least when the component part has been supplied—either originally or as a replacement part—by the same party who provided the rest of the equipment or project.[329] Instead, the court regarded the component part as part of the integrated whole.[330]

Likewise in *Pugh v. General Terrazzo Supplies, Inc.*, the court stated that damage to a finished product caused by a component part does not constitute damage to "other property."[331] And the Eastland Court of Appeals expressed the same view in *Trans-Gulf Corp. v. Performance Aircraft Services, Inc.*[332] When the plaintiff tried to recover for replacement and incidental costs under the theory that the damage was caused solely by deficiencies in fuel tanks, the court held that all of the damage was to the product of the contract.[333] Therefore, the economic loss rule applied and barred recovery in tort.[334]

The converse situation is illustrated in *Munters Euroform GMBH v. American National Power, Inc.*[335] In that case, the Austin Court of Appeals declined to apply the economic loss rule to bar tort recovery for equipment damaged in a fire caused by an evaporative cooler contained within the

[329] Equistar Chems. L.P. v. Dresser-Rand Co., 123 S.W.3d 584, 588–89 (Tex. App.—Houston [14th Dist.] 2003), *rev'd*, 240 S.W.3d 864 (Tex. 2007).

[330] *See id.* at 588.

[331] 234 S.W.3d at 92.

[332] 82 S.W.3d 691, 696–97 (Tex. App.—Eastland 2002, no pet.).

[333] *Id.* at 696.

[334] *Id.* at 697.

[335] No. 03-05-00493-CV, 2009 WL 5150033, at *5–6 (Tex. App.—Austin Dec. 31, 2009, no pet.) (unreported mem. op.).

equipment.[336] The court held that, in evaluating a claim against a subcontractor:

> [T]he scope of the subcontract—not the entire scope of the general contract—define[s] the scope of the economic loss doctrine's bar of negligence claims. To be entitled to a directed verdict [based on the economic–loss rule], Euroform was required to establish as a matter of law that the scope of its subcontract included all of the property that was damaged by fire."[337]

Although it may be possible to show that property beyond a specific subcontract constitutes "other property," it appears unlikely that the economic loss rule in Texas will be avoided by defining the product as solely a component part when that part comes from the same source as the remainder of the injured product or project furnished under the same contract.[338] Loss occurring to the whole product of the contract will not be considered injury to "other property" so as to escape the economic loss rule.[339]

J. Exception for Special Relationships

Even in cases in which the economic loss rule might otherwise be applied, an exception to the economic loss rule potentially exists for those cases in which a fiduciary relationship or a special relationship of trust exists between the plaintiff and defendant.[340]

What is the reason for this exception? It is true that, as a general proposition, there should be no liability in tort for pure economic harm simply based upon the negligent performance of a contract resulting in loss only to the subject of a contract, because the law of contracts is better suited to resolve this kind of liability, and imposing tort liability would disrupt and potentially invalidate the risk allocations of the parties and the role of

[336] *Id.* at *6.

[337] *Id.* at *5–6. *But see* Schambacher v. R.E.I. Elec., Inc., No. 2-09-345-CV, 2010 WL 3075703, at *7 (Tex. App.—Fort Worth Aug. 5, 2010, no pet.) (unreported mem. op.) (stating that economic loss rule bars negligence recovery against electrical and insulation subcontractors whose negligent conduct allegedly results in burning down the entire house under construction).

[338] *Munters*, 2009 WL 5150033, at *5.

[339] *Id.* at *6.

[340] *See, e.g.*, Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 500 (Tex. 1991).

contract law.[341] But this principle should not apply when there is an independent duty arising outside of the contract which has not been changed by the contract's terms, or which should not be allowed to be changed by contract, such as when there is a gross disparity in knowledge or bargaining power or a justified trust of one party by another, as in fiduciary situations or in justified reliance situations.[342]

When representing the plaintiff, it is important to examine a contractual relationship for the existence of a "special relationship" between the contracting parties because breach of the duties that accompany these special relationships can support extra-contractual (i.e., tort) remedies.[343] This is true even though the relationship and its corresponding duties would not exist but for the contractual agreement creating the relationship.[344] For example, professional malpractice is not just a breach of contract; the special relationship can give rise to duties enforceable as torts.[345] Similarly, an insurer has a special relationship with the insured, and if an insurer breaches a contract with the insured it can give rise to a tort.[346]

Although certainly special relationships include relationships characterized by fiduciary duties, there are other contractual relationships which do not constitute full fiduciary relationships, but for which there is at least a duty of good faith and fair dealing.[347] Of course, contracts accompanied by an independent duty of good faith and fair dealing are the exception, not the rule, in Texas. The Texas Supreme Court has held that there is not a general duty of good faith and fair dealing in all contracts.[348] And although the UCC imposes an obligation of good faith on every contract or duty that falls within its confines, it also states that this UCC

[341] *See id.* at 494.

[342] *See id.* at 500.

[343] *See id.*

[344] *Id.* at 494.

[345] *Id.* at 494 n.1.

[346] *Id.* at 500; *see also In re* Heartland Payment Sys., Inc. Customer Data Sec. Breach Litig., No. H-10-171, 2011 WL 1232352, at *21 n.7 (S.D. Tex. March 31, 2011) (containing recitation by Judge Lee Rosenthal of authority from New Jersey and New York stating that the economic loss rule does not apply to claims for breach of fiduciary duty).

[347] English v. Fischer, 660 S.W.2d 521, 524 (Tex. 1983) (Spears, J., concurring) (noting that Texas courts have found fiduciary or other special relationships in many familiar areas including agency, partnership, joint adventurers, insurance, oil and gas, and professional services); Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp., 823 S.W.2d 591, 594 (Tex. 1992).

[348] *Fischer*, 660 S.W.2d at 522; *see also* Cent. Sav. & Loan Ass'n v. Stemmons Nw. Bank, N.A., 848 S.W.2d 232, 238 (Tex. App.—Dallas 1992, no writ).

obligation does not support an independent cause of action for failure to perform or enforce in good faith.[349] Numerous appellate courts have noted that the obligation of good faith found in the code does not state an independent cause of action and that any breach of the statutory duty of good faith, standing alone without a special relationship, gives rise only to a cause of action for breach of contract.[350]

The special relationship required to circumvent strict application of the economic loss rule and of the *Reed/DeLanney* factors arises either from an element of trust necessary to accomplish the goals of an undertaking or by virtue of a special relationship imposed by the courts due to an imbalance of bargaining power.[351] A special relationship exists as a matter of law in many situations (e.g., relationships defined as being fiduciary in nature, and relationships defined as not being of a fiduciary nature but nevertheless necessarily carrying a duty of good faith and fair dealing, such as the relationship of an insurer to an insured).[352] In other situations, the existence of a special relationship is a question of fact, and when a special relationship has been found, it has been based on one party's excessive control over or influence in another's business activities.[353]

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[349] N. Natural Gas Co. v. Conoco, Inc., 986 S.W.2d 603, 606 (Tex. 1998); *see also Fischer*, 660 S.W.2d at 525 (Spears, J., concurring) (citing Business and Commerce Code, 60th Leg., R.S., ch. 785, § 1, sec. 1.203, 1967 Tex. Gen. Laws 2343, 2352 (amended 2003) (current version at TEX. BUS. & COM. CODE ANN. § 1.304 (West 2009))). While the Texas Legislature has amended the code to relocate the good faith provision to Section 1.304, the language of that section is identical to the predecessor cited in the cases in this footnote and in note 350, *infra*. *See* TEX. BUS. & COM. CODE ANN. § 1.304 cmt. (West 2009) ("[Section 1.304] is identical to former Section 1-203.").

[350] Hallmark v. Hand, 885 S.W.2d 471, 480 (Tex. App.—El Paso 1994, writ denied) (citing Business and Commerce Code, 60th Leg., R.S., ch. 785, § 1, sec. 1.203, 1967 Tex. Gen. Laws 2343, 2352 (amended 2003) (current version at TEX. BUS. & COM. CODE ANN. § 1.304 (West 2009))); *Cent. Sav. & Loan Ass'n*, 848 S.W.2d at 239 (citing Business and Commerce Code, 60th Leg., R.S., ch. 785, § 1, sec. 1.203, 1967 Tex. Gen. Laws 2343, 2352 (amended 2003) (current version at TEX. BUS. & COM. CODE ANN. § 1.304 (West 2009))); Adolph Coors Co. v. Rodriguez, 780 S.W.2d 477, 482 (Tex. App.—Corpus Christi 1989, writ denied) (citing Business and Commerce Code, 60th Leg., R.S., ch. 785, § 1, sec. 1.203, 1967 Tex. Gen. Laws 2343, 2352 (amended 2003) (current version at TEX. BUS. & COM. CODE ANN. § 1.304 (West 2009))).

[351] *See Fischer*, 660 S.W.2d at 524 (Spears, J., concurring); *see also* Sanus/N.Y. Life Health Plan, Inc. v. Dube-Seybold-Sutherland Mgmt., Inc., 837 S.W.2d 191, 199 (Tex. App.—Houston [1st Dist.] 1992, no writ).

[352] *Crim Truck*, 823 S.W.2d at 594 (Tex. 1992).

[353] Greater Sw. Office Park, Ltd. v. Tex. Commerce Nat'l Bank, 786 S.W.2d 386, 391 (Tex. App.—Houston [1st Dist.] 1990, writ denied).

Because of the element of trust found in a fiduciary relationship, all formal fiduciary relationships fall within the ambit of a special relationship; but because not all relationships involving trust and confidence come within a formally recognized fiduciary relationship, the courts have acknowledged the existence of a less formal confidential relationship in those cases "in which influence has been acquired and abused, in which confidence has been reposed and betrayed."[354] Clearly, trust and reliance on promises to perform a contract between parties is not enough by itself to rise to a confidential relationship because every contract includes some element of trust that the contract will be performed.[355] Neither length of a business relationship, cordiality of the parties nor the subjective trust by any party will convert a typical arms-length transaction into a fiduciary relationship.[356] "To impose an informal fiduciary duty in a business transaction, the special relationship of trust and confidence must exist prior to, and apart from, the agreement made the basis of the suit."[357] Without a special relationship between the parties, it has been held that any duty to act in good faith is contractual in nature and does not give rise to an independent tort cause of action.[358]

Texas courts have found that there generally is no automatically existing special relationship in certain areas such as electric utility/customers,[359] banks/customers,[360] borrowers/lenders,[361] creditors/guarantors,[362]

[354] *Crim Truck*, 823 S.W.2d at 594 (quoting Tex. Bank & Trust Co. v. Moore, 595 S.W.2d 502, 507 (Tex. 1980)); *see also* Meyer v. Cathey, 167 S.W.3d 327, 331 (Tex. 2005) ("We also recognize an informal fiduciary duty that arises from 'a moral, social, domestic or purely personal relationship of trust and confidence.'").

[355] *Crim Truck*, 823 S.W.2d at 594–95 (citing Consol. Gas & Equip. Co. v. Thompson, 405 S.W.2d 333, 336 (Tex. 1966)); *see also* Thigpen v. Locke, 363 S.W.2d 247, 253 (Tex. 1962).

[356] *Thigpen*, 363 S.W.2d at 253.

[357] *Meyer*, 167 S.W.3d at 331.

[358] Cent. Sav. & Loan Ass'n v. Stemmons Nw. Bank, N.A., 848 S.W.2d 232, 239 (Tex. App.—Dallas 1992, no writ).

[359] DeWitt Cnty. Elec. Co-op., Inc. v. Parks, 1 S.W.3d 96, 104 (Tex. 1999) (no fiduciary or special relationship between electric utility and its customers).

[360] Mfrs. Hanover Trust Co. v. Kingston Investors Corp., 819 S.W.2d 607, 610 (Tex. App.—Houston [1st Dist.] 1991, no writ) (no fiduciary or special relationship between banks and their customers).

[361] *Id.* (finding that the borrower/lender relationship is neither fiduciary nor special).

[362] Fed. Deposit Ins. Corp. v. Coleman, 795 S.W.2d 706, 709 (Tex. 1990) (no duty of good faith between creditor and guarantor).

debtors/creditors,[363] and employers/employees[364] (at least with regard to a duty owed by the employer to the employee in an employment-at-will context). But even in situations where courts have said that there generally is no special relationship, there may be extraneous facts or party conduct that may lead to the finding of a special relationship such as excessive control or influence of one party over another,[365] an excessive imbalance of bargaining power,[366] or an abuse of acquired influence and confidence.[367]

Additionally, in situations in which a fiduciary duty exists, there is also a corresponding duty on third parties not to knowingly participate with the fiduciary in a breach of the fiduciary duty.[368] Just as the economic loss rule is inapplicable to the breaching fiduciary, it is presumably inapplicable to the joint tortfeasor who is aiding and abetting the breach of fiduciary duty.[369]

K. The Question of Privity

To this point, the Texas Supreme Court has based its recognition of the economic loss rule exclusively on the first rationale of protecting the line between contract and tort. In the process, it has recognized two prongs of the Texas economic loss rule:

> 1. Application to purely economic loss claims for defective products; and

[363] Thigpen v. Locke, 363 S.W.2d 247, 253 (Tex. 1962) (no fiduciary duty between creditor and debtor).

[364] Wal-Mart Stores, Inc. v. Coward, 829 S.W.2d 340, 343 (Tex. App.—Beaumont 1992, writ denied) (no special relationship owed by employer toward employee in employment-at-will scenario).

[365] Greater Sw. Office Park, Ltd. v. Tex. Commerce Nat'l Bank, 786 S.W.2d 386, 391 (Tex. App.—Houston [1st Dist.] 1990, writ denied).

[366] English v. Fischer, 660 S.W.2d 521, 524 (Tex. 1983) (Spears, J., concurring); *see also* Sanus/N.Y. Life Health Plan, Inc. v. Dube-Seybold-Sutherland Mgmt., Inc., 837 S.W.2d 191, 199 (Tex. App.—Houston [1st Dist.] 1992, no writ).

[367] *Greater Sw. Office Park*, 786 S.W.2d at 391.

[368] *See, e.g.*, Kinzbach Tool Co. v. Corbett-Wallace Corp., 160 S.W.2d 509, 514 (Tex. 1942); Kastner v. Jenkens & Gilchrist, P.C., 231 S.W.3d 571, 580 (Tex. App.—Dallas 2007, no pet.) (stating that when a third party knowingly participates in the breach of a fiduciary duty, the third party becomes liable as a joint tortfeasor).

[369] *See Kastner*, 231 S.W.3d at 580.

2. Application to purely economic loss claims for failure to perform a contract.[370]

In addition, the Texas Supreme Court has expressly declined to date to adopt "a third formulation of the economic loss rule" based on the second rationale for an economic loss rule, to simply restrict the recovery of pure economic loss in negligence actions generally.[371]

In those jurisdictions applying a more broadly stated economic loss rule (e.g., federal courts deciding federal maritime cases in which the economic loss rule bars recovery of pure economic losses in tort without regard to any contractual relationship), privity is largely irrelevant.

Under Texas law, however, it is vital to recognize that privity matters.[372] Privity is not always required for application of the economic loss rule in Texas, but it is in most cases.[373]

The Texas Supreme Court has dealt extensively with situations involving a negligence claim brought against a defendant with whom the plaintiff is in contractual privity, in cases such as *Scharrenbeck*, *Jim Walter Homes*, and *DeLanney*.[374] Application of the economic loss rule to these types of contractual privity negligence claims is firmly grounded in the first rationale for the economic loss rule, that when purely economic loss is the subject matter of a contract between the parties it usually is better handled under contract law than negligence law.[375]

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[370] Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 418 (Tex. 2011) ("[W]e have applied the economic loss rule only in cases involving defective products or failure to perform a contract. In both of those situations, we held that the parties' economic losses were more appropriately addressed through statutory warranty actions or common law breach of contract suits than tort claims.").

[371] *Id.* at 419–20.

[372] *See* Louisiana *ex rel.* Guste v. M/V Testbank, 752 F.2d 1019, 1053 (5th Cir. 1985), and subsequent cases citing to that holding. In a choice of law determination between federal maritime law and Texas state law, the application of Texas law regarding the economic loss rule could be pivotal in leading to a different result. *See, e.g.*, Seven Seas Fish Mkt., Inc. v. Koch Gathering Sys., Inc., 36 S.W.3d 683, 688 n.5 (Tex. App.—Corpus Christi 2001, pet. denied) (declining to make choice of law determination for application of economic loss rule to oil spill for which federal maritime law is not applicable because potential conflict of Texas law not timely raised).

[373] *Sharyland*, 354 S.W.3d at 418–19.

[374] Montgomery Ward & Co. v. Scharrenbeck, 204 S.W.2d 508, 510 (1947); Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986); Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 500 (Tex. 1991).

[375] *Sharyland*, 354 S.W.3d at 417–18.

A different version of the economic loss rule has been applied until recently by some Texas lower courts to a negligence claim brought against a defendant in a non-commercial and therefore non-contractual context, where there is no contractual privity.[376] The first and most common rationale for the economic loss rule—to protect the boundary between contract and torts—has nothing to do with this application. It is instead tied to the second rationale advanced for barring economic loss negligence claims, to simply place limits on how far a negligence claim can reach.[377] The Texas Supreme Court has now expressly declined to endorse the economic loss rule in this second category of negligence cases.[378]

There exists another category of cases between these two polar-opposite contexts.[379] Numerous opinions from various courts of appeals have held that the economic loss rule may be applied between contractual strangers, i.e. between parties without privity, when doing so protects the contractual risk allocations actually made with other parties in the transaction.[380] The Texas Supreme Court has likewise expressed great reservation with this line of cases as well.[381]

The majority and dissenting opinions in the Fifth Circuit maritime case of *Louisiana ex rel. Guste v. M/V Testbank* explore the competing policy reasons behind the decision of whether or not to apply the economic loss rule to all negligence actions without contractual privity.[382] Professor William V. Dorsaneo has voiced approval of the dissent in that opinion (which argues against blanket application of the economic loss rule in negligence cases without privity), and further stated:

> Texas Supreme Court precedent has adopted an economic loss rule in negligence cases when the loss is the subject matter of a contract between the parties, but not otherwise. This version of the economic loss rule is based on the view

[376] *See* Trans-Gulf Corp. v. Performance Aircraft Srvs., Inc., 82 S.W.3d 691, 695 (Tex. App.—Eastland 2002, no pet.).

[377] *Id.*

[378] *Sharyland*, 354 S.W.3d at 418–19.

[379] *See, e.g.*, Hou-Tex, Inc. v. Landmark Graphics, 26 S.W.3d 103, 106–07 (Tex. App.—Houston [14th Dist.] 2000, no pet.) (applying the economic–loss rule to preclude tort recovery for costs of a dry well against a software designer whose software did not properly predict where to drill, where there was no contractual privity between the plaintiff and the software designer).

[380] *See, e.g.*, *id.* at 107.

[381] *Sharyland*, 354 S.W.3d at 420.

[382] 752 F.2d 1019, 1030–32, 1053 (5th Cir. 1985).

> that the nature of the loss consigns the rule of decision to the law of contracts. The court of appeals' recognition of a free-standing barrier to the recovery of foreseeable economic losses in negligence cases has no similar raison d'etre and represents a very poor policy choice.[383]

The Texas Supreme Court, in *Sharyland*, appears to agree.[384]

[383] 2000 William V. Dorsaneo III, *Texas Torts Update* 397 (MB) (Dec. 2000).

[384] *Sharyland*, 354 S.W.3d at 418–19.