CONSEQUENTIAL, NO DAMAGES FOR DELAY, LIQUIDATED DAMAGES AND SIMILAR DAMAGE CLAIMS AND APPLICATION OF THE ECONOMIC LOSS RULE

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I. INTRODUCTION

Over the past decade, almost every substantial commercial or construction case has contained breach of contract claims along with a variety of tort causes of action asserted alternatively or as additional and independent theories of recovery. Given the uncertain state of the law, it would have been imprudent for plaintiffs' counsel to plead otherwise. The difficulty in dealing with such cases eased to some degree based upon the Texas Supreme Court decisions in *Jim Walter Homes, Inc. v. Reed* and *Southwestern Bell Telephone Co. v. DeLanney* which deny negligence recovery in contract cases.

Subsequent appellate and Supreme Court decisions both clarified and extended the Court's analysis while others created additional questions. Does the Court's analysis reach only negligence claims? How are fraudulent inducement cases affected? Can a fraud claim co-exist with an enforceable contract and/or an unenforceable contract? What does an "independent" tort mean under the current state of the law? The Court recently answered these questions in the case of *Formosa Plastics Corp. USA v. Presidio Engineers.*

II. THE "ECONOMIC LOSS" RULE

Technically speaking, the "Economic Loss" Rule only applies to negligence and strict liability causes of action and precludes recovery where the only loss sustained is nothing more than economic loss rather than loss as a consequence of personal injury or property damage. True "Economic Loss" Rule cases can be neatly segregated into either one of two categories: (1) cases where the parties are complete strangers with no contractual or other relationship, and (2) cases where the parties are in privity of contract, either directly or, with respect to a product, in a transactional chain. Negligence and strict liability cases demonstrate the rule's utility.

No reported Texas decisions of any consequence deal with the application of the Rule to cases between complete strangers. But, one law review has described an accurate hypothetical: If a driver plows his car through a shop window, damaging the shop owner's store, the owner, and his goods, forcing the business to shut down for a period of time, the owner has a negligence claim for personal injury, property

damage, and consequential economic loss, all of which are recoverable. On the other hand, if the same driver causes a wreck on the street which blocks traffic and disrupts the shop owner's business, the shop owner has no injury other than economic loss and hence, no negligence cause of action against the driver. Any recovery for his loss is foreclosed unless he has business interruption insurance. Powers and Niver, *Negligence, Breach of Contract, and the "Economic Loss" Rule*, 23 Tex. Tech L. Rev. 477, 480-81 (1992).

A recent example of the application of the Economic Loss Rule among strangers comes from the Fifth Circuit in the case of *Louisiana, ex rel., Guste v. M/V Testbank*, 752 F.2d 1019 (5th Cir. 1985), *cert denied, sub nom, White v. M/V Testbank*, 477 U.S. 903 (1986). In *Testbank*, a group of business owners along the Mississippi River sued a vessel and its owners for negligence to recover the business interruption losses sustained when the Testbank foundered in the Mississippi River causing an oil spill which required river traffic to be halted for an extended period of time. No personal injury or property damage for the incident and resulting oil spill was alleged. The Fifth Circuit (en banc), relying upon circuit precedence based on the decision of the United States Supreme Court in *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303 (1927), completely denied the plaintiffs any recovery on their claims based upon the Economic Loss Rule.

The second group of cases are those where the parties are not contractual strangers either being in privity of contract or related through a transactional chain of title. It is in these cases where the common law distinction in Texas between damages available for tort and contract are most clearly defined by the Economic Loss Rule. For example, a defective product can give rise to either a strict liability cause of action or a breach of warranty cause of action depending on the nature of the harm sustained. When a defective product is unreasonably dangerous to users or consumers, a seller is liable for physical harm caused to the ultimate user or his property regardless of privity. *McKisson v. Sales Affiliates, Inc.*, 416 S.W.2d 787 (Tex. 1967) (adopting *Restatement (2d) of Torts* § 402A in Texas). The rationale is to provide a legal duty to protect consumers from injury.

When, on the other hand, the damage sustained is simply the economic loss which results from defective workmanship and materials, there is no recovery in strict liability. The lost value resulting from a failure of the product to perform is governed by the warranty provisions of the Uniform Commercial Code. *Nobility Homes of Texas, Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977). In other words, unless the defective product causes personal injury or damage to property (other than to the defective product itself), the Economic Loss Rule precludes recovery in tort for strict liability and confines the plaintiff to remedies under the Uniform Commercial Code. *Mid-Continent Aircraft Corp. v. Curry County Spring Serv., Inc.*, 572 S.W.2d 308 (Tex. 1978) (defect causing injury to product itself is an economic loss not covered

by strict liability); *Melody Home Mfg. Co. v. Morrison*, 455 S.W.2d 825 (Tex. Civ. App.--Houston [1st Dist.] 1970, no writ).

III. THE "CONTORT" DILEMMA

A. *Introduction*

In recent years, Texas courts have applied an analysis similar to the Economic Loss Rule to decide whether tort and contract claims can simultaneously exist and/or whether recovery can be had in tort for what otherwise is a breach of contract. This is the so-called "contort" analysis and is based upon the Supreme Court opinions in *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617 (Tex. 1986) and *Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493 (Tex. 1991). A related issue is whether a negligent breach of contract is also a tort. *See, Montgomery Ward & Co. v. Scharrenbeck*, 146 Tex. 153, 204 S.W.2d 508 (1947). Whether a given set of facts give rise to recovery in contract or in tort can have a number of ramifications, not the least of which is the ability to recover punitive damages. Clearly, punitive damages are available to a tort litigant, but are such damages ever available to a contract litigant?

In Texas, a breach of contract alone, no matter how intentional or malicious, cannot support the recovery of exemplary or punitive damages. *Bellefonte Underwriters Ins. Co. v. Brown*, 704 S.W.2d 742 (1986); *Amoco Production Co. v. Alexander*, 622 S.W.2d 563 (Tex. 1981). In a breach of contract case, however, a party may recover exemplary damages if that party can prove an "independent" tort together with a finding of actual damages as a result of that conduct. *Texas Nat'l Bank v. Karnes*, 717 S.W.2d 901 (Tex. 1986). In a "contort" case, the rub lies with the word "independent." These ramifications will be discussed later. However, suffice it to say, punitive damages have become the catalyst making it extremely important to determine whether a given set of facts gives rise to coexisting contract and tort claims, mutually exclusive contract and tort claims, alternative contract and tort claims, or mere breach of contract.

B. *Development*

Two early decisions laid the groundwork for the Supreme Court's more recent "contort" analysis. In *International Printing Pressmen & Assistants Union v. Smith*, 145 Tex. 399, 198 S.W.2d 729 (1946), the plaintiff sued to recover actual and exemplary damages for wrongful expulsion from his union. A judgment n.o.v. was entered by the trial court in favor of the union based on the contention the plaintiff's cause of action was in tort rather than contract and therefore barred by the two-year statute of limitations. *Id.* at 735. The Supreme Court was required to address the

general distinction between contract and tort actions, observing it to be often difficult to determine with "no universally accurate or acceptable definition of either class."

> [G]enerally speaking, "actions in contract and in tort are to be distinguished in that an action in contract is for the breach of a duty arising out of a contract either express or implied, while an action in tort is for a breach of duty imposed by law." . . . It is sometimes said that "if the action is not maintainable without pleading and proving the contract, where the gist of the action is the breach of the contract, either by malfeasance or nonfeasance, it is, in substance, an action on the contract whatever may be the form of the pleading."

Id. at 735 (citation omitted). Looking to the facts and analyzing the "duties", the Court determined the constitution and bylaws of the union constituted a contract between the organization and its members; the plaintiff complied with this contract and the union breached it; all of the rights for which the plaintiff sought redress arose by virtue of the agreement; and, therefore, his action was founded upon a contract in writing. *Id.* at 736. The fact the plaintiff sought (although he did not recover) exemplary damages did not preclude a contract recovery since, according to the Court, tort and contract theories could alternatively be alleged. *Id.*

The second but more problematic case is *Montgomery Ward & Co. v. Scharrenbeck*, 146 Tex. 153, 204 S.W.2d 508 (1947). There, Montgomery Ward's employee undertook for a fee to repair a water heater in the plaintiff's home. Shortly after the repair and while the repairman was still on site, the heater ignited the roof, destroying the house and its contents. In the Supreme Court, the question was whether the trial court properly denied the defendant's special exceptions as to the plaintiff's pleadings of negligence. *Id.* at 510. The springboard of the Court's opinion and that portion which is most often cited is a quotation from *American Jurisprudence on Negligence*.

> A contract may create the state of things which furnishes the occasion of a tort. The relation which is essential to the existence of the duty to exercise care may arise through an express or implied contract. 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 contract. In such a case, the contract is mere inducement creating the state of things which furnishes the occasion of the tort. In other words, the contract creates the relation out of which grows the duty to use care.

Id. (emphasis added). Because of the procedural posture of the case, the Court did not discuss in detail the ramifications of whether the case before it sounded in contract or in tort. Clearly, contract and tort law were implicated, however, the Court discussed only negligence and found the defendant owed a legal duty not to physically damage person or property.

The appealing generality of the Court's quote in *Scharrenbeck* is enticing to litigants, especially in construction and service-related cases. Most contracts expressly (or at least impliedly) call for work to be performed in a "good and workmanlike" manner and free from defect. Traditional notions say a failure to so perform is a failure of consideration or a breach of contract. *Westbrook v. Watts*, 268 S.W.2d 694, 697 (Tex. Civ. App.--Waco 1954, writ ref'd n.r.e.). There, Plaintiff sued to recover the balance due him for his well drilling services which the defendant failed to pay claiming the work was not performed in a good and workmanlike manner. In affirming a judgment for plaintiff, the Court's discussion focused on this contractual duty and the trial court's definition in a defensive issue in the jury charge. *Id.* at 696-98.

Remarkably, in the fifty years this case has been on the books, no Texas appellate court has ever truly held or found that negligent performance of contractual duties actually gave rise to tort liability and punitive damages between contracting parties, ala *Scharrenbeck*. A review of *Scharrenbeck*'s progeny demonstrates it has only been cited as a general statement of the law routinely utilized by courts in an introductory manner with no decisions turning on the quote from *Scharrenbeck*. In every case of an action between parties to a contract, the *Scharrenbeck* common law duty was discussed in contractual terms without regard to a tort analysis. *Coulson v. Lake LBJ M.U.D.*, 734 S.W.2d 649 (Tex. 1987) (negligent performance of contract as an affirmative defense in a contract action); *Texas P&L v. Barnhill*, 639 S.W.2d 331 (Tex. App.--Texarkana 1982, writ ref'd n.r.e.) (same); *Compton v. Polonski*, 567 S.W.2d 835 (Tex. Civ. App.--Corpus Christi 1978, no writ); *New Trends, Inc. v. Stafford-Lowden, Inc.*, 537 S.W.2d 778 (Tex. Civ. App.--Fort Worth 1976, writ ref'd n.r.e.); *Westbrook v. Watts, supra.*

On the other hand, in every case involving tort recovery for negligence, a third party to the contract was physically injured on a construction site or otherwise by a contracting party's negligence. In each case, clearly recognized legal duties to provide safe workplaces or exercise ordinary care were found. *Coastal Constr. Co. v. Tex-Kote, Inc.*, 571 S.W.2d 400 (Tex. Civ. App.--Waco 1978, writ ref'd n.r.e.) (fall from Astrodome Roof); *Davis v. Anderson*, 501 S.W.2d 459 (Tex. Civ. App.--Texarkana 1973, no writ) (ditch cave-in); *HMR Constr. Co. v. Woolco Houston, Inc.*, 422 S.W.2d 214 (Tex. Civ. App--Houston [14th Dist.] 1967, writ ref'd n.r.e.); *Panhandle Gravel Co. v. Wilson*, 248 S.W.2d 779 (Tex. Civ. App.--Amarillo 1952, writ ref'd n.r.e.) (failure to properly load gravel truck launched rock into car).

Finally, in one venue case, the Austin Court of Appeals found a bulkhead contractor had no contract or negligence cause of action against the owner's engineer for defective plans since the engineer was the owner's agent and the owner was a party to the suit. *Bernard Johnson, Inc. v. Continental Constructors, Inc.*, 630 S.W.2d 365 (Tex. App.--Austin 1982, writ ref'd n.r.e.). Although this case did not trigger a "contort" analysis as such, for a venue case, the opinion provides a significantly detailed analysis of distinctions between contractual duties and legal duties.

Thus, until the mid-1980s, litigants were fairly content to rely on traditional concepts of negligence or contract and confined the relief sought to either theory of recovery; injury begat negligence cases and failure to perform (negligent or otherwise) stayed in the family of contract.

IV. THE "CONTORT" ANALYSIS

A. *Jim Walter Homes*

In *Jim Walter Homes, Inc. v. Reed*, the plaintiffs brought suit seeking actual and punitive damages arising out of the sale and construction of a home. The jury found the defendant breached the warranty of good workmanship in the contract and that it was grossly negligent in its supervision of the construction. The jury found actual damages, additional DTPA damages, gross negligence, exemplary damages, and attorney's fees. The trial court awarded actual damages, attorney's fees, disallowed the DTPA additional damages, and remitted a portion of the exemplary damages. The Court of Appeals modified the judgment by awarding DTPA damages only and attorney's fees but, in addition, ordered a remittitur further reducing the exemplary damages. The Supreme Court was solely concerned with the award of punitive damages.

In reversing the award of punitive damages, the Supreme Court invoked the true Economic Loss Rule in combination with an amplification of its decisions in *Pressmen* and *Scharrenbeck*.

> Although the principles of contract and tort causes of action are well-settled, often it is difficult in practice to determine the type of action that is brought. We must look to the substance of the cause of action and not necessarily the manner in which it was pleaded. [*Pressmen*]
>
> The contractual relationship of the parties may create duties under both contract and tort law. [*Scharrenbeck*] The acts of a party may breach duties in tort or contract alone or simultaneously in both. <u>The nature of the injury most often determines which duty or duties are</u>

> breached. When the injury is only the economic loss to the subject of a contract itself, the action sounds in contract alone. [*Mid-Continent* and *Nobility*]

Id. at 617-18 (emphasis added). According to the Court, the nature of the injury to plaintiffs was the house they were promised and the house for which they paid was not the house they received--breach of contract. Therefore, a grossly negligent breach of contract "will not entitle an injured party to exemplary damages because even an intentional breach will not." *Id.*

Jim Walter Homes is significant to say the least. From the above-quoted paragraph, the "contort" analysis sprang. Recognizing punitive damages are misplaced in a case without a distinctly tortious injury, the Court reiterated the rule that a breach of contract, even if intentional, cannot support the recovery of exemplary damages. It also overlaid a "nature of injury" analysis to the analysis of duty for distinguishing between a contract in tort case. However, because the substantive question before the Court was the recoverability of punitive damages only, the scope of *Jim Walter' Homes* was viewed by some courts as limited.

B. *Southwestern Bell v. DeLanney*

The most significant application of *Jim Walter Homes* was the case of *Southwestern Bell Tel. Co. v. DeLanney*. In that case, the plaintiff sued Southwestern Bell alleging negligence and the DTPA based upon Southwestern Bell's failure to publish his Yellow Pages advertisement in its 1980-81 directory. Because his advertising contract with Southwestern Bell contained a clause limiting liability to a refund, the plaintiff presumably chose not to bring a breach of contract claim. The jury found the deletion of the advertisement caused the plaintiff to suffer lost profits of almost $110,000 during the year and $40,000 for lost future profits. The DTPA cause of action was dismissed by directed verdict. The Texarkana Court of Appeals affirmed the trial court's judgment in a plurality opinion. *Southwestern Bell Tel. Co. v. DeLanney*, 762 S.W.2d 772 (Tex. App.--Texarkana 1988).

In the Court of Appeals, Southwestern Bell complained of the submission of a negligence theory to the jury claiming the plaintiff's cause of action sounded in contract alone. Southwestern Bell relied upon *Pressmen* claiming an action in contract is for a breach of duty arising from contract while an action in tort is for breach of a duty imposed by law. Southwestern Bell also relied on *Jim Walter Homes* for the proposition the "nature of the injury" alleged precluded a negligence cause of action. The majority disregarded both lines of cases opining casually that the focus of those cases was on the award of exemplary damages. Instead, the majority determined a negligence cause of action was stated based upon *Scharrenbeck*. That is, since a party to a contract owes a common-law duty to

perform the contract with care, skill, and reasonable expedience, a negligent failure in performing any of these conditions can be the basis for recovery in tort as well as a breach of contract. *Id.*

The Chief Justice wrote a separate concurring opinion to emphasize the "narrow and peculiar circumstances" which he believed permitted a tort recovery in that case. According to the Chief Justice, the distinction was based upon the difference between nonfeasance and misfeasance.

> The complete failure to perform is only a breach of contract, and is not a tort unless the duty imposed by the contract is one which is also imposed by law. . . . The negligent performance of a contract, however, can be a tort as well as a breach of contract.

Id. at 777 (Cornelius, C. J., concurring) (emphasis in the opinion, citations omitted). The Chief Justice believed negligent performance rather than a failure to perform was the gist of the plaintiff's case and allowed recovery in tort.

According to the dissent, a negligent breach of contract did not change the action into a tort. The dissent analyzed the various factors judicially employed to separate tort and contract theories of recovery: (1) *Pressmen*--an action in contract is for the breach of a duty arising out of a contract, while an action in tort is for a breach of duty imposed by law; (2) *Jim Walter Homes*--the nature of the injury most often determines the duty or duties which are breached; and (3) the proposition of no tort liability for nonfeasance (based upon the concurring opinion interpreting *Scharrenbeck*). According to the dissent, the application of all three tests demonstrated plaintiff's cause of action was based upon contract. (*Id.* at 778) (Grant, J., dissenting).

The Supreme Court of Texas granted the application for writ of error, reversed the Court of Appeals' judgment, and rendered judgment that plaintiff take nothing. *Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493 (Tex. 1991). The majority downplayed the Court of Appeals' reliance on *Scharrenbeck* in favor of the nature of duty and injury analysis from *Jim Walter Homes*.

> If the 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 in contract.

Id. at 494. According to the Court, the phone company's duty to publish the advertisement arose solely from the contract rather than a duty imposed by law. The plaintiff's damages in the form of lost profits were only for the economic loss caused by the failure to perform. Although the plaintiff pleaded a cause of action stated in negligence, "he clearly sought to recover the benefit of his bargain" and therefore, the phone company's failure to publish the advertisement was not a tort but, rather, a claim solely in contract pursuant to *Jim Walter Homes*. *Id.* at 495.

The Court also acknowledged tort duties which exist even with a contract. In a footnote the Court stated, "Of course, some contracts involve special relationships that may give rise to duties enforceable as torts, such as professional malpractice." *Id.* at 494 n.1. In his concurring opinion, Justice Doggett recognized another--the special relationship between insurer and insured. *Id.* at 500 (Doggett, J., concurring). Two subsequent appellate courts have agreed. *Sanus/New York Life Health Plan, Inc. v. Dube-Seybold-Sutherland Mgmt., Inc.*, 837 S.W.2d 191 (Tex. App.--Houston [1st Dist.] 1992, no writ); *USAA v. Pennington*, 810 S.W.2d 777 (Tex. App.--San Antonio, 1991, writ denied). Justice Grant's dissent in *DeLanney* also identified breach of fiduciary duty arising from contract as another instance. *DeLanney*, 762 S.W.2d at 778 n. 1 (Grant, J., dissenting).

A concurring opinion by Justice Gonzalez further diluted the continuing vitality of *Scharrenbeck*. According to Justice Gonzalez, relying on *Pressmen*, if the action cannot be maintained without pleading and proving the contract, the action is for breach of contract either by malfeasance or nonfeasance.

> I believe that this formulation comes closer than *Scharrenbeck* to stating a general rule to distinguish contract from tort and that the broad language in *Scharrenbeck* must be read in light of the particular circumstances of that case. The opinion in *Scharrenbeck* is correct in its observation that a contract may be the occasion that brings the parties together, but it is the relationship or situation of the parties that gives rise to a duty in law, the breach of which is a tort. . . . Had Montgomery Ward repaired the heater gratuitously, it would have owed Scharrenbeck a duty not to create a dangerous condition. . . . Thus the duty to not create a dangerous condition existed independent of any contractual relationship.

Id. at 496 (emphasis added) (Gonzalez, J., concurring). Although the majority in *DeLanney* did not overrule or limit *Scharrenbeck*, it is very difficult to now conceive of a situation where a negligent breach of contract can ever be turned into a tort cause of action as shown below. But, what about other torts?

V. CONTORTS POST-*DELANNEY*

A. *Negligence and Contract*

In *Thomson v. Espey Huston & Assoc., Inc.*, 899 S.W.2d 415 (Tex. App.--Austin 1995, no writ) the Austin Court of Appeals dealt with an action brought by a property owner against an engineering and consulting firm alleging breach of contract for engineering and design services and for inspection services regarding construction of an apartment complex as well as negligence in the performance of duties under those contracts. A joint venture contracted with two of its partners for the construction of an apartment complex and those partners, in turn, entered into two contracts with Espey, an engineering consulting firm. The first contract required Espey to perform a variety of engineering and design services including the design of drainage structures, facilities for controlling storm water runoff, and for water and wastewater distribution systems. Espey was also responsible for soil testing and recommendations concerning the foundation and pavement. The second contract required Espey to perform inspections on the construction site and report upon the process of the construction of the apartment complex, as a condition to continued financing. Following substantial completion of the project, "it became apparent that the complex was riddled with design and construction defects" related to drainage and water runoff. *Id.* at 417. By summary judgment, the trial court dismissed the plaintiff's claim in its entirety including the plaintiff's negligence claims as being barred by the Economic Loss Rule.

On appeal, the Court of Appeals examined both contracts to determine whether any of Espey's actions caused injury beyond the economic loss of the two contracts. With regard to the draw inspection contract, the Court found Espey had no duty to inspect or report problems on the construction site absent the contract. Therefore, since the plaintiff merely sought the failure to receive the benefit of its bargain, "Espey's performance under the contract, however negligent, could violate only a contractual duty unless, as in *Scharrenbeck*, the negligence caused damage beyond the subject of the contract itself." *Id.* at 421.

With regard to the other contract, the Court found Espey's engineering and design services could give rise to a tort cause of action. In that regard, the plaintiff alleged Espey was negligent in the design of the drainage system which caused damage to other parts of the apartment complex outside of the scope of Espey's contract.

> Such damage is beyond the subject of the contract itself, distinguishing this case from *Jim Walter Homes*, wherein the defendant was contractually obligated to provide the entire house. . . . If Thomson were merely complaining that the drainage system was

> inadequate and that he had been forced to repair or improve it, he would have only a contractual claim. Likewise, if Thomson were merely complaining that the soil testing services were inadequate and that he had been forced to supplement Espey's services at his own expense, he would have only a contractual claim. However, to the extent that the alleged inadequacies caused damage to parts of the property beyond Espey's contract, Thomson also has a tort claim.

Id. at 422. The Court of Appeals found Espey had an independent legal duty outside of the contract not to damage the plaintiff's property or the property of his neighbors. To that extent, the Court of Appeals reversed the entry of summary judgment and remanded the case to resolve that issue only.

Espey is the most thoughtful and thorough post-*DeLanney* application of the Court's "contort" analysis. The Court did not apply the analysis as a bright-line test, but instead, observed the nature of the allegation, duties, and losses to arrive at the correct result.

B. *Independent Torts*

In *Motsenbocker v. Potts*, 863 S.W.2d 126 (Tex. App.--Dallas 1993, no writ), the plaintiff, who had sold his business and had been retained as a consultant by the buyer, brought an action against the buyer and other parties for breach of contract, fraud, and intentional infliction of emotional distress. The defendants, among other things, secretly modified plaintiff's healthcare plan deductible from $300 to $50,000 with full knowledge plaintiff was, at the time, diagnosed with terminal cancer. *Id.* at 129, 133-34. Following trial, the jury found a breach of contract and that the defendants had maliciously committed intentional infliction of emotional distress.

The jury found no fraud. The trial court awarded actual damages and attorney's fees for breach of contract and actual damages and exemplary damages for intentional infliction of emotional distress. *Id.* at 131. On appeal, the defendants contended the intentional infliction of emotional distress issue should not have been submitted because the plaintiff's theory of recovery allegedly sounded in contract only. *Id.* at 138. The Court of Appeals disagreed, finding a duty not to intentionally inflict emotional harm arises under common law irrespective of the existence of a party's contract. *Id.* Accordingly, the judgment was in all respects affirmed. This case represents a good example of a contract action coupled with a free-standing and truly "independent" tort.

C. *Fraudulent Inducement*

The most problematic contort scenario after *DeLanney* involved cases where fraud or fraudulent inducement of contract were claimed in addition to or notwithstanding an existing contract. In *Schindler v. Austwell Farmers Co-Op*, 841 S.W.2d 853 (Tex. 1992) the Supreme Court did not touch on the "contort" analysis, however, its affirmance of the Court of Appeals' opinion caused confusion which would be cleared up five years later in *Formosa.*

In *Schindler*, the Supreme Court modified a Court of Appeals opinion to delete a punitive damage award, finding there was no evidence the defendant had no intention of honoring a promise to pay at the time the promise was made, relying on *Spoljaric v. Percival Tours, Inc.*, 708 S.W.2d 432 (Tex. 1986). Because of this finding, the Court did not address the propriety of allowing the plaintiff to recover both attorney's fees for breach of contract and punitive damages for fraud based upon the same event and the same injury. To understand the extent of the problem created, the Court of Appeals' decision must be examined.

The dispute before the Corpus Christi Court of Appeals involved a plaintiff's suit for breach of contract and fraud in response to which the jury found $65,000 owed on the account; the defendant fraudulently obtained products from plaintiff causing damages in the amount of $65,000; and the recovery of punitive damages for fraud and attorney's fees for breach of contract. *Schindler v. Austwell Farmers Co-Op*, 829 S.W.2d 283, 285 (Tex. App.--Corpus Christi 1992). In summary, the Court of Appeals held, although failure to perform a contract usually yields contract rather than tort liability, a fraud claim is stated when a promise to perform is made with no intention to perform. *Id.* at 286.

Although the amounts were the same, the *Schindler* jury answered two separate damage questions for breach of contract and fraud. In a lengthy opinion on rehearing, the Court of Appeals reexamined but refused to change its opinion in response to a *Jim Walter Homes* argument concerning the duplicate contract and tort damages. Simply stated, the Court of Appeals rejected the need for a distinctly tortious damage in addition to contract damage, believing a party who enters a contract with no intention of performing, shows intent to harm and is liable for exemplary damages even if the nature of the harm sounds in contract. *Id.* at 291. In response to the contention the identical damages dictated a contract recovery, the Court bolstered its opinion by citing *American Nat'l Petrol. Corp. v. Transcontinental Gas Pipeline Corp.*, 798 S.W.2d 274 (Tex. 1990) ("*ANPC*").

> In a commercial relations tort, the fact that the damages are "economic" does not mean that they may not be damages for the tort. The basic measure of actual damages for tortious interference with

> contract is the same as the measure of damages for breach of the contract interfered with, to put the plaintiff in the same economic position he would have been in had the contract interfered with been actually performed.

Id. at 279. *ANPC* stands for the proposition that a plaintiff may simultaneously recover actual damages and attorney's fees for breach of contract and, in addition, punitive damages from a defendant if an independent tort is pleaded and findings made of the distinctly tortious act and injury as a result. In that case Transco breached its contract with ANPC and also tortiously interfered with contracts ANPC had with others. The *Schindler* Court of Appeals' simply ignored the measure of damages as indicative.

The Supreme Court in *Schindler* chose not to reach the issues concerning the relationship between contract and fraud in the inducement. This refusal, the Court's prior use of labels such as "benefit of the bargain" to distinguish contracts from torts in general, and the eagerness of litigants and courts of appeals to grasp for bright-line tests, created a split of authority on the propriety of coexistent fraud and contract claims.

D. *Split of Opinions*

The rift between the post-*DeLanney* decisions from the Texas Courts of Appeals was significant. Of the ten courts considering whether fraudulent inducement of contract claims were to be construed and excluded by virtue of the "contort" analysis from *Jim Walter Homes* and *DeLanney*, five courts held tort damages not to be recoverable for a fraudulent inducement claim unless the Plaintiff suffered an injury distinct, separate and independent from economic losses recoverable under a breach of contract claim (Dallas, Fort Worth, Tyler and both Houston Courts of Appeals). This view was also adopted by the United States Court of Appeals for the Fifth Circuit in its Texas cases. The courts adopting this view focus their attentions upon the nature of the injury prong of the contorts analysis. Through a fraudulent inducement claim, the plaintiffs in these cases sought to recover the "benefit of their bargain" triggering an automatic rejection of a tort recovery for an injury compensable under contract law.

On the other hand, the other five Courts of Appeals rejected an application of the "contorts" analysis to fraudulent inducement claims (Austin, Beaumont, Corpus Christi, El Paso and San Antonio). The rationale behind these views was varying save only for a reluctance to focus on the label given to the plaintiff's "measure of damages." In other words, if a viable cause of action for fraudulent inducement could be pleaded and proven, a tort recovery was allowed notwithstanding the existence of a contract.

The split of opinion among the Courts of Appeals became so severe that a "choice of law" procedural issue was created when a case was transferred from a court of one view to the court of another view. Specifically, in *American Nat'l Ins. Co. v. Intern'l Bus. Mach. Corp.*, 933 S.W.2d 685 (Tex. App.--San Antonio 1996, writ denied), a case within the jurisdictional region of the Houston Courts of Appeals was transferred to San Antonio to relieve a congested docket situation in Houston. The San Antonio court was faced with a dilemma. If it decided the case consistent with its prior opinions, then a fraudulent inducement claim was allowable. However, it was observed San Antonio might be bound to follow the prior precedent from the Houston Courts of Appeals which was diametrically opposed to that of San Antonio simply because the case bore a Houston appellate docket number. Ultimately, the Court held plaintiff stated an independent tort cause of action based upon fraudulent inducement and the question of "choice of law" was discussed in a concurring and dissenting opinion. *Id.* at 689, 689-96 (Duncan, J., concurring and dissenting). Although the Supreme Court denied an application for writ of error in this case, the conflict was soon resolved.

E. *Conflict Resolved*

In the summer of 1997, the Supreme Court of Texas delivered its opinion in the case of *Formosa Plastics Corporation USA v. Presidio Engineers*, 40 Tex. Sup. Ct. J. 877 (July 9, 1997). There, Presidio responded to an invitation to bid from Formosa on part of a project requiring the construction of 300 concrete foundations. The bid package contained certain representations concerning the foundation job: (1) Presidio would arrange and be responsible for scheduling, ordering and delivery of all materials including those paid for by Formosa; (2) work was to progress continually from commencement to completion; and (3) the job was scheduled to commence on July 16, 1990 and be completed ninety (90) days later. Additionally, the bid package provided Presidio would be responsible for all weather and other unknown delays therefore he added another thirty (30) days to his bid all of which was accepted. The job was substantially delayed and took over eight (8) months to complete which caused Presidio to incur substantial additional costs which were not anticipated when the project was bid. *Id.* at 878.

At trial, evidence was submitted that Formosa enticed contractors to make low bids by making misrepresentations in the bid package regarding scheduling, delivery of materials and responsibility for delay damages. One of Formosa's engineers admitted Formosa had secretly decided to set up its own delivery schedule in order to save money, contrary to the bid package. Formosa also scheduled multiple contractors doing mutually exclusive work to be in the same area at the same time causing interruption of Presidio's pouring work while another contractor installed underground pipe. Formosa's inspector admitted the company knew contractors would be working "on top of each other" but did not inform the

contractors. When delay damages were presented under the contract, Formosa relied on its superior economic position and offered contractors far less than the full and fair value of the delay damages. This strategy was also admitted. *Id.*

On appeal from a judgment in favor of Presidio for $700,000 in actual damages and $10 million in punitive damages, Formosa asserted that Presidio's fraud claim could not be maintained as the losses were purely economic and related to performance and the subject matter of the contract -- unrecoverable in tort pursuant to *DeLanney.* Presidio contended the analysis from *DeLanney* did not apply to fraud claims. The Supreme Court of Texas agreed with *Presidio*. *Formosa*, 40 Tex. Sup. Ct. J. at 878-79.

The Court began its analysis by reviewing the fifty (50) year history of its efforts to differentiate between tort claims and contract claims. In the process, the Court continued to adhere to the need for an analysis of the source of the duty and the nature of the injury as "guidelines." *Id*. at 879-80 (citing, *Pressmen, Jim Walter Homes, and DeLanney).* After recognizing the split in appellate court decisions over the application of *DeLanney* to fraudulent inducement claims, the Court specifically rejected the application of *DeLanney* "to preclude tort damages in fraud cases." *Id.* at 880. Looking to the first guide post, the Court clearly held:

> Texas law has long imposed a duty to abstain from inducing another to enter into a contract through the use of fraudulent misrepresentations. As a rule, a party is not bound by a contract procured by fraud.... Moreover, it is well established that the legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself.

Id. at 880. In this regard, the Court reiterated a fraud claim can be based on a promise made with no intention of performing, irrespective of whether the promise is later subsumed within a contract. The "nature of the injury" guide post likewise did not preclude a fraud or tort recovery. "Our prior decisions also clearly establish that tort damages are not precluded simply because a fraudulent representations causes only an economic loss." *Id.* at 881. According to the Court, tort claims and economic losses were not mutually exclusive depending on the nature of the tort alleged. *Id.* citing *ANPC* (tortious interference with contract).

The Court did not content itself with merely clearing up the conflicting opinions from the lower Courts of Appeals. The Court went further and reviewed the question of whether the evidence was legally sufficient to support the damages awarded. In this process, the Court continued to recognize two measures of direct damages for common law fraud; the out-of-pocket measure and the benefit-of-the-

bargain measure. *Id.* at 883. Under either measure, the Court found the evidence did not support the verdict.

Recently, the Supreme Court denied rehearing but issued a revised opinion. *Formosa Plastics Corp. USA v. Presidio Engineers*, 41 Tex. Sup. Ct. J. 289 (Jan. 16, 1998). The Court's decision and opinion regarding the contort issue remained unchanged, the Court did alter its damage analysis which produced a stinging dissent.

Without detailing the evidence and the Supreme Court's determination of the proper calculations, (a subject beyond the scope of this paper) this portion of the opinion is highly suggested reading for those with claims similar to *Presidio*. (*See* Section III, pp. 293-97; Baker, J. Dissenting, pp. 297-99).

VI. CONCLUSION

The common tort claims which generally accompany a breach of contract cause of action in commercial and construction-related cases include: negligence, gross negligence, negligent misrepresentation, fraud, fraudulent inducement and tortious interference. Before litigants assert any of these tort claims along with a breach of contract action, the cases above strongly suggest an examination of the tort claims with a "contort" analysis in mind and an understanding of whether the tort claims are "independent" of a contract claim. While the "contort" analysis should not be applied in a formulaic fashion, the following examples are indicative of the solution derived from such an analysis.

As between parties to a contract, it seems clear negligence or gross negligence claims will fail unless the recovery sought is for injury to person or property outside the scope of the contract. *Scharrenbeck*; *Espey*. Whether such a negligence claim can be asserted against a third party to the contract (e.g., an architect or engineer) remains largely unanswered. However, because of doctrines of agency and third-party beneficiary, such a claim could likewise be precluded. *See, Bernard Johnson, Inc.*

On the other hand, tortious interference, by its very nature, should pass muster outside of a "contort" analysis. In a properly pleaded tortious interference case, the defendant is a third party to the contract charged with interfering with such contract. A plaintiff's recovery for benefit of the bargain flows from the defendant's wrongful interference. Use of the "benefit of the bargain" measure of damages label should no longer prompt a "contort" challenge.

An improperly pleaded claim of negligent misrepresentation will also fail a "contort" analysis. Specifically, the negligent misrepresentation doctrine as adopted in Texas restricts a claimant to pecuniary loss sustained in reliance on the

representation and expressly precludes recovery of "benefit of the bargain" type damages. Thus, if recovery of "benefit of bargain" damages is sought in a negligent misrepresentation case, the claim will not only fail a "contort" analysis but, more importantly, is also improperly pleaded.

Finally, as resolved by *Formosa*, a party induced into a contract by fraud may pursue a contract claim and an alternative fraud claim subject to proper pleading and proof. The law imposes a duty to refrain from fraudulent conduct regardless of whether the fraud results in a contract and without regard to a similar measure of damage for both fraud and contract actions. The Economic Loss Rule remains vital and viable in Texas. However, like other rules, it cannot be applied in a vacuum.

VII. APPENDIX

Introduction

Almost every jurisdiction nationwide, including the United States Supreme Court, recognizes the application of the true "Economic Loss Rule" in strict liability, products liability in negligence cases. *See, East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986) (adopting the rule for maritime cases). Many states have also utilized the Economic Loss Rule to separate tort and contract causes of action. Most states observe a contractual relationship could give rise to a tort recovery in addition to a contract action if the duty breached is imposed by law. Several states go so far as to say the plaintiff in such an instance may pursue a claim for breach of contract and a breach of duty in tort simultaneously but must elect between these alternative theories. All jurisdictions were reviewed and the laws of thirty-one of those states on this subject are set forth below. The jurisprudence of the remaining eighteen states were not sufficiently developed to demonstrate a clear body of law.

Alabama

Alabama focuses on the conduct of the defendant in terms of misfeasance or non-feasance. Failure to perform a contractual obligation as specified is not a tort and cannot be unless the non-performance is by reason of a failure to exercise the case required by law in attempting to perform. *Tenn. Coal, Iron & RR Co. v. Sizemore*, 62 So.2d 459, 463 (Ala. 1952). However, the same act may be a breach of a contract as well as a duty implied by law giving rise to an election between either cause of action. *Berry v. Druid City Hosp. Bd.,* 333 So.2d 796, 800 (Ala. 1976); *Lemon v. Gulf Terrace Owners Assn.*, 611 So.2d 263, 264 n.1 (Ala. 1992). Because the contract may create, induce or cause a condition which furnishes the occasion of a tort, both may exist. *Roberts v. Public Cemetery of Cullman*, 569 So.2d 369, 372 (Ala. 1990).

Alaska

The development of the law in Alaska has been tied to the relationship between the parties (i.e., insurer/insured and professional malpractice). In Alaska, a duty of good faith and fair dealing is a tort in insurance cases only. *State Dep't of Nat. Res. v. Transamerica Premier Ins. Co.*, 856 P.2d 766, 774 (Alaska 1993); *State Farm Fire & Cas. Ins. Co. v. Nicholson*, 777 P.2d 1152, 1154-57 (Alaska 1989). In other cases, a breach of this duty is a mere breach of contract between the parties. *Arco Alaska v. Akers*, 753 P.2d 1150, 1154 (Alaska 1988) (employment agreement). In an arm's length construction contract, the failure to pay claims for extra costs is

a breach of contract at best, not a tort. *Transamerica*, 856 P.2d at 774. On the subject of liability for defective plans and specifications, Alaska holds a design professional has a duty to exercise reasonable care and ordinary skill to avoid injury to person or property through negligence. A project owner has a claim under contract but also for malpractice v. the designer. However, a contractor's claim against an owner for deficient plans prepared by a designer is limited to a contractual warranty of implied fitness for purpose and a claim for increased costs does not arise outside of the contract. *Transamerica*, 856 P.2d at 772.

Arizona

Arizona applies the traditional Economic Loss Rule in product and strict liability actions. If the injury is confined to the property itself rather than other personal property the Plaintiff's recovery is limited to warranty. *Salt River Project Agric. Improv. & Power Dist. v. Westinghouse Elec. Corp.*, 694 P.2d 198 (Ariz. 1984). In other types of cases, Arizona looks to the nature and source of the implied covenant or obligation (i.e., implied by law or contract). In addition, special duties characterized by public interest, adhesion and fiduciary responsibility create additional duties implied by law. *Rawlings v. Apodaca*, 726 P.2d 565, 575 (Ariz. 1986) (insurers, common carriers, inn keepers, physicians and attorneys all have tort and contractual duties). Should the fact a breach of an agreement constitutes a failure to exercise care as amounts to a tort, a plaintiff may elect between either. *Id.; Ins. Co. of N. Amer. v. Santa Cruz*, 800 P.2d 585, 588 (Ariz. 1990).

Arkansas

This state is another which looks to the source of the duty and allows an election between theories. However, a breach of contract is not a tort. *Quinn Companies, Inc. v. Herring-Marathon Group, Inc.*, 773 S.W.2d 94 (Ark. 1989). If the same conduct may give rise to either contractor tort liability the claims may be pursued alternatively. *Sterling Drug, Inc. v. Oxford*, 743 S.W.2d 380 (Ark. 1988); *Thomas Auto Co., Inc. v. Kraft*, 763 S.W.2d 651 (Ark. 1989); *L. L. Cole & Son, Inc. v. Hickman*, 665 S.W.2d 278, 281 (Ark. 1984). Failure to perform a contract is not negligence. *JRT, Inc. v. TCBY System, Inc.*, 52 F.3d 734, 738 (8th Cir. 1995).

California

California looks to the nature of the duty to determine this question. There it is recognized contract law exists to enforce legally binding agreements whereas tort law is designed to vindicate social policy. *Allied Equip. v. Litton Saudi Arabia*, 869 P.2d 454, 459-60 (Cal. 1994). Conduct amounting to a breach of contract becomes tortious only when it violates an independent duty arising by law. An omission to perform a contract is never a tort unless it is an omission of a legal duty. *Id.; Arntz*

v. St. Paul Fire & Mar. Ins. Co., 54 Cal. Rptr. 2d 888 (Cal. App. 1 Dist. 1996) (claim of malicious termination of bond and allegedly false reports being sent to reinsurers may have affected plaintiff's business but a breach of contract is not transmuted into a tort by malice).

Colorado

Here, contract claims are premised on the theory parties create duties to each other by agreement and common law requires they perform them. This duty to perform mutually agreed upon obligations is not the equivalent of a generally recognized duty of care for negligence. *Martinez v. Badis*, 842 P.2d 245, 252 (Colo. 1992) (*en banc*). There is no cause of action in tort for negligent breach of contract resulting in economic loss and it should not be transformed into a tort to avoid an obstacle to a contract recovery. *Chellsen v. Pena*, 857 P.2d 472, 477 (Colo. App. 1992); *Ins. Co. of N. Amer. v. Aspen Alps Condo*, 915 F. Supp. 1122 (D. Colo. 1996) (tort claim barred by limitations, contract claim viable).

Connecticut

Connecticut courts are largely swayed by the Economic Loss Rule. In *Hudson River Cruises, Inc. v. Bridgeport Drydock Corp.*, 892 F. Supp. 380 (D. Conn. 1994), a vessel owner sued a drydock alleging failure to repair and paint a hull in a good and workmanlike manner. The court found the claim for the cost of hauling, sandblasting and repainting the ship was governed by contract law rather than tort. These purely economic losses were simply the result of failing to receive the benefit of a bargain therefore, contract and warranty theory governs in a commercial context where parties are generally capable of allocating risk between themselves. *Id.* at 386. *See also, McKernan v. United Technologies Corp.,* 717 F. Supp. 60 (D. Conn. 1989) (economic loss due to poor resale value of allegedly defective helicopter covered by warranty law as opposed to tort law per the Economic Loss Rule). But *see, Stowe v. Smith,* 441 A.2d 81 (Conn. 1981) (unless there is a conflict between tort and contract law, a plaintiff may pursue either alternatively).

Florida

Except for duties owed by professionals, Florida recognizes strict adherence to the Economic Loss Rule is required. An example is the case of *Florida P&L v. Westinghouse Elec. Corp.*, 510 So.2d 899 (Fla. 1987). There, FPL purchased steam generators for its nuclear power plant from Westinghouse and, on discovering leaks in all six, sued for breach of express warranties and negligence. The damages sought were for costs of repair, revision and inspection. The court restricted the claim to warranty finding the Economic Loss Rule barred a tort recovery without a claim for personal injury or property damage other than the allegedly defective good. *CH2M*

Hill S.E. v. Pinellas County, 598 So.2d 85, 88 (Fla. App. 2 Dist. 1992) (County claim against designer and manufacturer of defective pipeline confined to contact absent independent tort); *Hoseline Inc. v. USA Diversified Products, Inc.*, 40 F.3d 1198, 1199 (11th Cir. 1994) (Claims regarding under shipment governed by contract law rather than fraud or theft). Professionals such as title abstractors and architects are the exception as Florida believes a third party contractor could sustain foreseeable economic injury as a result of negligent performance of a contractual duty by these professions. *First Amer. Title Ins. Co. v. First Title Service Co. of the Florida Keys*, 457 So.2d 467 (Fla. 1984); *A.R. Moyer, Inc. v. Graham*, 285 So.2d 397 (Fla. 1973).

Georgia

Courts of this state look to the nature of the duty involved. Any breach of a contract must arise from the contract and does not give rise to a tort whether or not the breach was willful or negligent. *A. L. Williams &Assoc. v. Faircloth*, 386 S.E.2d 151, 154 (Ga. 1989) (no fraudulent termination of contract allowed); *American Honda Motor Co. v. Williams & Assoc., Inc.*, 431 S.E.2d 437 (Ga. App. 1993) (landowner had no negligence claim against contractor for failure to insure soil quality for lack of duty independent of contract). *See also, State Line Metals, Inc. v. Alcoa*, 453 S.E.2d 474, 477 (Ga. App. 1994) (recognizing the coexistence of two duties are possible).

Illinois

In Illinois, the dividing line between tort and contract involves an analysis of the nature of the defect and how the loss occurred. When a defect is by nature qualitative and harm relates to the expectation regarding a products quality, contract law provides the rule of recovery. Tort theory is suited in cases of injury or property damage from a sudden and dangerous occurrence. *Scott v. Fetzler Co. v. Montgomery Ward & Co.*, 493 N.E.2d 1022, 1026 (Ill. 1986) (defective fire alarm followed by fire which destroyed property and neighborhood not barred by Economic Loss Rule). In another case, a builder failed to state a negligence claim for which economic losses were asserted by virtue of obvious architectural errors. In such a case, the builder's recourse is in contract or conceivably fraud or negligent misrepresentation. *Fence Rail Dev. Corp. v. Nelson & Assoc. Ltd.*, 528 N.E.2d 344 (Ill. App. 2 Dist.) *appeal denied,* 535 N.E.2d 401 (Ill. 1988). Illinois does recognize some relationships create both duties, however, both breaches must be asserted and they cannot be combined into anything other than alternative causes of action. *Armstrong v. Guigler*, 673 N.E.2d 290, 296 (Ill. 1996).

Iowa

Iowa is a strict Economic Loss Rule state. *Richards v. Midland Brick Sales Co.*, 551 N.W.2d 649 (Iowa App. 1996). Ordinarily a breach of contract is not a tort, although a contract can create a duty the breach of which may be tortious. *Cross v. Lightolier*, 395 N.W.2d 844, 849 (Iowa 1986) (wrongful discharge is not a tort). However, a Plaintiff cannot recover in tort when only economic losses are suffered. *Nelson v. Todd's, Ltd.*, 426 N.W.2d 120, 123 (Iowa 1988).

Indiana

Here, a plaintiff has the option of suing in tort or in contract for negligent performance of a contractual duty. *Strayer v. Covington Creek Condos*, 678 N.E.2d 1286, 1288 (Ind. App. 1997) (however, court found failure to maintain sidewalk which caused injury was a negligence action). Indiana does not recognize the novel claim of tortious breach of contract, however, and a plaintiff can only receive punitive damages if a tortious act is shown in addition to a breach of contract. *Comfax v. N. Amer. Van Lines*, 587 N.E.2d 118, 123 (Ind. App. 1 Dist. 1992). *See, Flynt & Walling Mfg. Co. v. Becket*, 79 N.E. 503, 506 (Ind. 1906) (duty can arise by contract or in law simultaneously and a plaintiff must elect between the two).

Kansas

Kansas focuses on the nature of the duty. The development of Kansas law in this regard has been spurred by an analysis of duties owed by professionals. There, although the breach of a contractual duty is not ordinarily a duty imposed by law, it has been held architecture is an exact science unlike law or medicine and a person contracting for a specific result can sue in contract, implied warranty or negligence. *Tamarac Dev. Co., Inc. v. Delamater, Frund & Assoc.*, 675 P.2d 361, 363, 365 (Kan. 1984). Otherwise, when a duty arises by contract, the remedy is solely under the contract for failure to perform. *Foy Constr. Co. v. Professional Mech. Contr.*, 766 P.2d 196, 201 (Kan. App. 1988) (contractor's claim against sub was limited to contract); *Atchison Casting Corp. v. DeFasco, Inc.*, 889 F.Supp. 1445, 1461 (D. Kan. 1995).

Louisiana

Louisiana looks to the nature of the conduct involved. Neglecting what the contract obligates is a passive breach of contract; negligent performance is active negligence therefore active breach of contract. Passive breach is only a contract claim while active breach allows both. *Huggs, Inc. v. LPC Energy, Inc.*, 889 F.2d 649, 655 (5th Cir. 1989) (*citing*, La. Civ. Code, art. 2315). The courts of Louisiana also look to the nature of the duty which has been breached. *Roger v. DufFrene*, 613

So.2d 947 (La. 1993) (failure to procure insurance is a tort); *Baldwin v. Antin*, 673 So.2d 1049 (La. App. 1 Cir. 1996) (wrongful eviction and breach of lease could be both contract or tort).

Maryland

Maryland courts look to the nature of the duty and the relationship between the parties. There, a negligent breach of contract, absent a legally imposed duty independent of the contract, is not enough to sustain an action in tort. *Bd. of Educ. v. Plymouth Rubber Co.*, 569 A.2d 1288, 1298 (Md. App.) *cert. denied*, 578 A.2d 778 (Md. 1990). Negligent performance and negligent misrepresentation claims are improper where the parties only relationship is contractual. *Martin Marietta v. Int'l Tele. Satellite Organization*, 991 F.2d 94, 98 (4th Cir. 1992).

Michigan

Michigan law is based upon an analysis of the distinction between misfeasance and non-feasance. Misfeasance is negligence during performance of a contract violating a duty of care to avoid injury. Violation of this duty could give rise to a tort. On the other hand, a failure to perform is non-feasance for which there is no tort liability. *Courtright v. Design Irr. Inc.,* 534 N.W.2d 181 (Mich. App. 1995) (a failure to complete a contract, as opposed to a failure to perform a contract, which exposes one to a risk of harm is misfeasance relying on Restatement (2d) Torts § 324(A)). Thus, where a contractor installs a roof under plans he knows to be deficient he is liable in tort for a failure to perform the contract with ordinary skill and care. *Amer. & Foreign Ins. Co. v. Bolt,* 106 F.3d 155, 158 (6th Cir. 1997). Further, fraud and negligent misrepresentations claims would not arise without a contract therefore, plaintiff's remedy is confined to contract. *Merchants Publ. Co. v. Maruka*, *Mach. Corp. of Amer.*, 800 F.Supp. 1490 (W.D. Mich. 1992).

Minnesota

Although the law here is not fully developed, it has been held bad faith or malicious termination of a contract is a breach of a contract and not a tort. *Wild v. Rarig*, 234 N.W.2d 775, 790 (Minn. 1975), *cert. denied* 424 U.S. 902 (1976) (motives only go to materiality of breach but the damages are the same). There is no negligent breach of contract, however, an independent tort accompanied by a breach of contract may allow for enhanced damages. *Lassen v. First Bank Eden Prairie,* 514 N.W.2d 831, 837 (Minn. App. 1994).

Missouri

In strict and products liability actions, Missouri follows the Economic Loss Rule. *Rock Port Pharmacy, Inc. v. Digital Symplistics, Inc.,* 53 F.3d 195, 198 (8th Cir. 1995). In other cases, Missouri looks to the source of the duty and if both are present a plaintiff must elect between the two causes of action. *Davidson v. Hess*, 673 S.W.2d 111, 113 (Mo. App. E.D. 1984). While recognizing a breach of contract does not create tort liability, acts or omissions which are a breach which could also violate a duty of care could give rise to tort liability. Where the only damage complained of is economic loss resulting from defects in an item sold or built under a contract, contract law affords complete relief and coterminous negligence actions will not lie. *Korte Constr. Co. v. Deaconess Manor Assoc.*, 927 S.W.2d 395, 405 (Mo. App. E.D. 1996) (failure to perform under a construction contract is not a tort).

Nebraska

Nebraska law is also driven by the source of the duty. There, courts must construe the essential and factual allegations rather than legal terminology. *Cimino v. Firstier Bank, N.A.,* 530 N.W.2d 606, 612 (Neb. 1995). The Supreme Court has held one may sue in tort where there has been negligence in the performance of a contract because of a common law duty to perform with care, skill and reasonable expediency. *Thomas v. Country Side of Hastings, Inc.*, 524 N.W.2d 311, 313-14 (Neb. 1994) (plaintiff's complaint based on faulty installation of furnace which damaged property is both contractual and tortious). However, where the only duty which exists arises by virtue of contract, there is no tort. *J. L. Healy Constr. Co. v. State*, 463 N.W.2d 813, 816 (Neb. 1990).

New Mexico

New Mexico cases do not reveal a uniform analysis. New Mexico recognizes negligent services may give rise to claims for both ordinary negligence and breach of contract. Where a contractor's misfeasance could forseeably cause personal injury or property damage, tort liability can arise. *Flores v. Baca*, 871 P.2d 962, 966 (N.M. 1994) (failure to completely embalm body inflicted emotional distress). But the failure to properly construct a home arises only by virtue of contract and does not give rise to an action in tort. *Kreischer v. Armijo*, 884 P.2d 827, 829 (N.M. App. 1994) (titling an action as one of gross negligence does not change its nature from a failure to perform pursuant to the terms of a contract).

New York

In New York, merely alleging a breach of a contractual duty arose from a lack of due care will not transform a simple breach of contract into a tort. *Sommer v.*

Federal Signal Corp., 593 N.E.2d 1365 (N.Y. 1992); *Nu-Life Constr. Corp. v. Bd. of Educ.*, 611 N.Y.S.2d 529, 530 (A.D. 1 Dept. 1994). But a legal duty may be present which exists independent of the contract. *Env. Safety & Control Corp. v. Bd. of Educ.*, 580 N.Y.S.2d 595, 596-97 (A.D. 4 Dept. 1992); *Castagna & Son, Inc. v. Bd. of Educ.*, 570 N.Y.S.2d 286, 287 (A.D. 1 Dept. 1991) (delay claims are contractual regardless of fraud allegations). Recently, the New York Court of Appeals sought to disentangle the "borderland" between tort and contract law. New York now looks to the source of the duty disregarding labels such as misfeasance and non-feasance as irrelevant. *Sommer*, 593 N.E.2d at 1369 (duty of professionals arises by law, not necessarily by contract). New York also looks to the nature of the injury and the resulting harm. *Id.* (benefit of the bargain is usually contract).

North Carolina

North Carolina looks to the source of the duty involved. There is no cause of action for negligent breach of contract, even where the breach was due to negligence or lack of skill. *Mason v. Yontz*, 403 S.E.2d 536, 538 (N.C. App. 1991). Tort damages are appropriate, however, where there is injury to a person or third-party property, injury to the promisee or his property other than the subject of the contract, damage to subject property where promisor is charged by law to safeguard the property from harm, or where willful injury to or conversion of the subject property occurs. *Id.*; *N. Car. State Sports Authority v. Lloyd A. Fry Roofing Co.*, 240 S.E.2d 345, 350-51 (N.C. 1978) (leaking roof is a failure to perform governed by contract or warranty law).

North Dakota

In combination with the Economic Loss Rule, North Dakota focuses its inquiry on the contractual relationship between the parties. *Cooperative Power v. Westinghouse Elec. Corp.*, 60 F.3d 1336, 1341 n.4 (8th Cir. 1995). A seller's negligence is not relevant to the question of whether the seller breached an express warranty to deliver conforming goods. Breach of contract does not subject to the actor to tort liability unless the conduct also constitutes a breach of duty independent of the contract. *Dakota Grain Co., Inc. v. Ehrmantrout*, 502 N.W.2d 234, 236-37 (N.D. 1993); *Cooperative Power v. Westinghouse Elec. Corp.*, 493 N.W.2d 661 (N.D. 1992) (distinction between tort and warranty law would be eliminated by holding manufacturer liable in tort for economic loss for damage to goods sold in commercial transactions.

Oklahoma

Oklahoma is another jurisdiction which recognizes that two types of duties can coexist and allow plaintiffs to seek both simultaneously but alternatively. For

example, upon physical failure of a structure, the plaintiff can recover the cost to remedy under contract theories and sue in tort for damage to personal property caused by the failure. *Flint Ridge Dev. v. Benham-Blair & Aff., Inc.*, 775 P.2d 797 (Okla. 1989).

Oregon

Oregon looks to the duty involved. Where a contractual relationship exists and the thrust of the claim is that one party caused damage to the other by negligently performing contractual obligations, even though the relationship is contractual, injured parties can sue for negligence if the other party is subject to a standard of care independent of the contract. If the claim is solely a breach of a contractual provision the action lies in contract. *Georgetown Realty, Inc. v. Home Ins. Co.*, 831 P.2d 7, 12 (Or. 1992) (insurer's duty of good faith is a tort); *Fessler v. Quinn*, 923 P.2d 1294, 1296 (Or. App. 1996) (professional has legally imposed duty independent of contract).

Pennsylvania

Two separate lines of reasoning exist in Pennsylvania to determine whether a claim arising from a contractual relationship is a contract or could be a tort. A complete failure to perform (non-feasance) is a breach of contract while improper performance (misfeasance) may also be a tort. *Raab v. Keystone Ins. Co.*, 412 A.2d 638, 639 (Pa. Super. 1979). On the other hand, without regard to non-feasance or misfeasance, courts look to the nature of the defendant's conduct to separate the causes of action. *Grode v. Mutual Fire Ins. Co.*, 623 A.2d 933, 935 (Pa. Cmwlth 1993). The Third Circuit recently acknowledged this unsettled dichotomy in Pennsylvania. *Valhal Corp. v. Sullivan Assoc., Inc.*, 44 F.3d 195, 208-09 (3rd Cir. 1995). Another Federal Court observed Pennsylvania would probably follow the Economic Loss Rule in order to confine a loss of good will to a breach of contract theory. *Lucker Mfg. v. Milwaukee Steel Fdy.,* 777 F.Supp. 413 (E.D. Pa. 1991) *appeal denied*, 983 F.2d 1051 (3rd Cir. 1992).

South Carolina

South Carolina believes the Economic Loss Rule simply observes the traditional distinction between contract and tort recoveries for a diminution and expected value of a product. Between contracting parties, there is no tort recovery for this type of loss. *Carolina Winds v. Joe Hardin Builder, Inc.*, 374 S.E. 897, 901-03 (S.C. App. 1988). For a tort to arise from a contract, there must also be a relationship, irrespective of contract, that gives rise to a duty. South Carolina finds the economic loss framework too general because it focuses on the consequences rather than action. The Supreme Court held, in partial rejection of *Carolina Winds*,

if a buyer performs in such a way that he violates a contractual duty only, recovery is only under contract; if a builder violates a legal duty in his performance, he is subject to tort and contract liability. *Kennedy v. Columbia Lumber & Mfg. Co.*, 384 N.E.2d 730, 737 (N.C. 1989).

Virginia

Virginia follows the Economic Loss Rule. The driving force behind tort law in Virginia is the safety of persons and property from injury. On the other hand, contracts law protects bargain for expectations. *Sensenbrenner v. Rust Orling & Neale*, 374 S.E.2d 55, 58 (Va. 1988) (recognizing a defectively built structure triggers only economic loss).

Washington

Washington again focuses on the duty. Generally, a breach of contract does not give rise to a tort action, unless negligence performance of a contact violates an independent duty imposed by law. *Amer. Nursery Products, Inc. v. Indian Wells Orchards*, 797 P.2d 477, 485 (Wash. 1990) (this general proposition assumed but not decided); *G. W. Constr. Corp. v. Prof. Service Industries, Inc.*, 853 P.2d 484, 487 (Wash. App. Div. 1 1993), *review denied*, 868 P.2d 871 (Wash. 1994) (professional duty of care arose by law without regard to contract).

West Virginia

West Virginia generally recognizes where duties arise only by virtue of a contract the action sounds in contract. But, where duties arise by law, recovery and tort is allowed for negligent design flaws giving rise to latent defects discovered by a subsequent homeowner. *Silk v. Flat Top Constr. Inc.*, 453 S.E.2d 356, 360 (W. Va. 1994) (suit against consultant for construction costs overruns was a contractual claim); *Sewell v. Gregory*, 371 S.E.2d 82 (W. Va. 1988) (latent defects in construction become apparent following heavy rains which allowed subsequent homeowner to sue for negligence).

Wisconsin

Wisconsin has adopted the Economic Loss Rule to preclude recovery of such losses between purchasers and sellers through a negligence cause of action. *Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc.*, 437 N.W.2d 213, 217-18 (Wis. 1989). There is no distinction between products or services where parties are in privity in Wisconsin. *Wausau Paper Mills v. Charles T. Main, Inc.*, 789 F.Supp. 968 (W.D. Wis. 1992). Also, Wisconsin requires the existence of an independent legal duty apart from the contract to impose any kind of tort liability.

Wisconsin Public Service Corp. v. Ecodyne Corp., 702 F.Supp. 217, 219 (E.D. Wis. 1988).

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