

**THE TEXAS “ECONOMIC LOSS” RULE
AND “CONTORTS”, SEPARATING
TORT FROM CONTRACT**
(Including an Overview of Other Jurisdictions)

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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’s decisions in *Jim Walter Homes, Inc. v. Reed* and *Southwestern Bell Telephone Co. v. DeLaney* 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 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.¹ 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.

Few Texas cases have thoroughly discussed the application of the Economic Loss Rule in any significant detail and no reported Texas decisions of any consequence deal with the application of the Rule to cases between complete strangers.² The most recent example of the application of

¹For a more thorough and exhaustive discussion of the history, scope, and applications of the rule, see Powers & Niver, *Negligence, Breach of Contract, and the “Economic Loss” Rule*, 23 Tex. Tech.L.Rev. 477 (1992). See also, Marple, *Requiescat for an Epitaph: Breach of Contract Is Not a Tort*, 56 Tex. B.J. 656 (July 1993).

²For example, Powers & Niver (*supra* n.1.) describe the following 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 fo 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 drive 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

(continued...)

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.2 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 transaction 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).³ 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).

²(...continued)

hence, no negligence cause of action against the driver. Any recovery for his loss is foreclosed unless he has business interruption insurance. 23 Tex. Tech L. Rev. 477, 480-81.

³In that case, a mobile home purchaser sued the manufacturer, rather than the dealer, seeking to recover the diminished value of the home due to defects, asserting strict liability and breach of the implied warranty of fitness. Since the home was not dangerous and caused no injury, the plaintiff was limited to a warranty claim. Direct contractual privity was not required. *Id.* at 79-81.

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 damage 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 Pressman & 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 a 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. *Westbrooke v. Watts*, 268 S.W.2d 694, 697 (Tex. Civ. App.–Waco 1954, writ ref’d

n.r.e).⁴ Casual reading and reliance on *Scharrenbeck* could have led litigants astray. 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 give rise to tort liability and punitive damages between contracting parties, ala *Scharrenbeck*.

A listing 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.⁵ 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 was found.⁶ 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.⁷

Thus, until the mid-1980's, 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.

⁴There, 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.

⁵*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*.

⁶*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).

⁷*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.

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 *Pressman* 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. [*Pressman*]

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. 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. [*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 overload 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.⁸ The jury found the deletion of the advertisement caused the plaintiff to suffer lost profits of almost \$100,000 during the year and \$40,000 for lost future profits. The DTPA case 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 *Pressman* 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 on those cases was on the award of exemplary damages.⁹ 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 of 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.

⁸Because 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.

⁹"Exemplary damages are not involved in this case. The only damages awarded to DeLanney were for lost profits, which are actual damages." *Id.* at 774.

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.¹⁰

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) *Pressman*—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 based upon contract.¹¹ (*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 494.¹² 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

¹⁰The Chief Justice, without reference to the merits of them, string-cited *Scharrenbeck* and its progeny (*see*, n. 5 and 6, *supra*) to support his conclusion.

¹¹Justice Grant, it should be noted, found *Scharrenbeck* to be questionable and distinguished its utility with respect to each of its progeny. (*Id.* At 778-79) (Grant, J., dissenting). The Texas Supreme Court agreed.

¹²In 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).

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 495.¹³

A concurring opinion by Justice Gonzalez further diluted the continuing vitality of *Scharrenbeck*. According to Justice Gonzalez, relying on *Pressman*, 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 information 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 observations that a contract may be the occasion that brings the parties together, but it is the relationship or situation of the parties that give 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. 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

¹³The use of the label “benefit of bargain,” though apt., has created problems.

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 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 has 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. Following trial, the jury found a breach of contract and that the defendants had maliciously committed intentional infliction of emotional distress. This case represents a good example of a contract action coupled with a free-standing and truly

“independent” tort. 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.

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 judgement was in all respects affirmed.

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).¹⁴ 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

¹⁴*Spoljaric* is authority for a species of fraud characterized by fraudulent inducement of contract through a promise of future performance made with no intent to perform. *Spoljaric*, 708 S.W.2d at 435.

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 291.¹⁵ 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.¹⁶ 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 property of coexistent fraud and contract claims.

D. Split of Opinions

The rift between the post-*DeLanney* decisions from the Texas Court 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 *Reed* and *DeLanney*, five courts held tort damages not to be recoverable for a fraudulent inducement claim unless the

¹⁵Only under the rarest of circumstances will a party be able to show some personal injury or harm to property not the subject of the contract to support a tort finding. If Appellant’s position is the state of the law and the policy of the courts of this state, *Spoljaric* would not be constantly cited for the proposition that fraudulent entry of contract is a tort.” *Id.*

¹⁶In ANPC, the Supreme Court affirmed a trial court judgment allowing a plaintiff to recover actual damages and attorney’s fees for breach of contract together with punitive damages based upon the jury findings of Transco’s tortious interference with ANPC’s contracts with others-an independent tort. The issue was whether an independent tort had been shown absent a jury finding of injury as a result of the tortious conduct. The Court held the independent tort rule was satisfied since the parties had stipulated that damages for breach of contract were the same as the damages for the defendant’s tortious interference with other contracts between the plaintiff and third parties.

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 tort analysis. Through a fraudulent inducement claim, the plaintiffs in these cases sought to recover the “benefit of the 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 “tort” 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 in 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 has 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 representations 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 sources of the duty and the nature of the injury as "guidelines." *Id.* at 879-80 (citing, *Pressman, Reed, DeLanney* and *Ace Sign*). 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 *American Natl' Petroleum Co. v. Transcontinental Gas Pipeline Corp.*, 798 S.W.2d 274, 278 (Tex. 1990) (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. 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. 883-84).

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 and an understanding of whether the tort claims are supportably “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., supra*, n. 7.

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 recover 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. Forewarned is forearmed.

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 the 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.