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CASE NO. 09-0223

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IN THE SUPREME COURT OF TEXAS

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SHARYLAND WATER SUPPLY CORPORATION  
Petitioner

v.

CITY OF ALTON, CARTER & BURGESS INC., CRIS EQUIPMENT COMPANY, AND  
TURNER COLLIE & BRADEN INC.  
Respondents

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**BRIEF OF AMICUS CURIAE R. CARSON FISK**

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R. Carson Fisk  
State Bar No. 24043659  
FORD NASSEN & BALDWIN P.C.  
111 Congress Ave., Suite 1010  
Austin, Texas 78701  
512.236.0009 (telephone)  
512.236.0682 (facsimile)

**IDENTITIES OF PARTIES AND COUNSEL**

**Parties**

**Sharyland Water Supply Corporation**

Petitioner

**City of Alton, Texas**

Respondent

**Carter & Burgess Inc.**

Respondent

**Turner Collie & Branden Inc.**

Respondent

**Cris Equipment Company Inc.**

Respondent

**R. Carson Fisk**

Amicus Curiae

**Counsel**

**Counsel for Sharyland Water Supply Corporation**

J. W. Dyer

Sharon Almaguer

DYER & ASSOCIATES

1352 W. Pecan Blvd.

McAllen, Texas 78501-4351

**Counsel for City of Alton, Texas**

Eileen Marie Leeds

WILLETTE & GUERRA L.L.P.

1534 E. 6th St., Suite 200

Brownsville, Texas 78520

**Counsel for Carter & Burgess Inc.**

Stephen L. Tatum

Tolbert L. Greenwood

Stephanie Kay Smith

Andrew Derald Keetch

CANTEY HANGER L.L.P.

600 W. 6th St., Suite 300  
Fort Worth, Texas 76102-3685

Jeffrey D. Roerig  
Rene O. Oliveira  
ROERIG OLIVEIRA & FISHER L.L.P.  
855 W. Price Rd., Suite 9  
Brownsville, Texas 78520

**Counsel for Turner Collie & Branden Inc.**

John B. Wallace  
BARKER LYMAN P.C.  
1221 McKinney St.  
3600 One Houston Center  
Houston, Texas 77010-2011

Marcus Montalvo  
MONTALVO LAW  
900 N. Main  
McAllen, Texas 78501

**Counsel for Cris Equipment Company Inc.**

Christopher Allen Funk  
WALKER & TWENHAFEL L.L.P.  
Frost National Bank Building  
2424 N. 10th St., Suite 200  
McAllen, Texas 78502

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## **INTEREST OF AMICUS CURIAE R. CARSON FISK**

Mr. Fisk is an attorney whose practice focuses on construction law. He has focused on this practice area for approximately six years. During this time, he has addressed and analyzed the application of the economic loss rule in cases similar to this, where there is no privity of contract between the parties. He has argued to lower courts concerning the matter and he has briefed the issue on several occasions. He has prepared an upcoming article to be released in the Construction Law Journal concerning the topic. He is also assisting in preparing a presentation for the annual meeting of the Construction Law Section of the Texas Bar Association concerning the topic. Mr. Fisk has received no fee from any source for the preparation of this brief.

## **ISSUE PRESENTED**

- I. Whether the economic loss rule should bar claims for economic damages when the parties are not in contractual privity and there is no accompanying claim for personal injury or property damages outside the scope of a contract.

## STATEMENT OF FACTS

This case arises from the installation of a sanitary sewer system.<sup>1</sup> In the Appellate Court, Carter and Burgess Inc. (“C&B”), Turner Collie & Braden Inc. (“TCB”), and Cris Equipment Company Inc. (“Cris”), contended that the Trial Court erred in submitting a negligence question because that claim is barred by the economic loss rule.<sup>2</sup>

Sharyland Water Supply Corporation (“Sharyland”) sued the City of Alton, Texas (“Alton”) for breach of a water supply agreement and water service agreements.<sup>3</sup> Sharyland also sued C&B, TCB, and Cris, all engineering firms, for negligence and breach of contract.<sup>4</sup> Sharyland alleged that sanitary sewer residential service connections were installed in violation of state regulations and industry standards and represented a threat to Sharyland’s potable water system.<sup>5</sup>

Sharyland’s breach of contract claim against Alton and its breach of contract and negligence claims against C&B, TCB, and Cris were tried to a jury.<sup>6</sup> As a part of its findings, the jury found that C&B, TCB, and Chris were negligent, that such negligence was the proximate cause of damages to Sharyland, and that liability should be apportioned jointly and severally, at twenty percent for C&B, forty percent for TCB, and forty percent for Cris.<sup>7</sup> The jury assessed damages at \$1,139,000 and awarded Sharyland

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<sup>1</sup> See *City of Alton v. Sharyland Water Supply Corp.*, 277 S.W.3d 132, 138 (Tex. App.—Corpus Christi 2009, pet. filed).

<sup>2</sup> See *id.* at 139.

<sup>3</sup> See *id.* at 140.

<sup>4</sup> See *id.* at 140.

<sup>5</sup> See *id.* at 140.

<sup>6</sup> See *id.* at 141.

<sup>7</sup> See *id.* at 141.

attorneys' fees.<sup>8</sup>

In its live pleading, Sharyland had sought damages for “increased costs in operation and costs to place barriers to mitigate the hazard caused by Defendants” and for “costs associated with increased safety precaution and maintenance measures it takes when repairing its lines.”<sup>9</sup> In determining the amount of damages that were proximately caused by the parties' negligence, the jury was instructed to consider only “[t]he reasonable cost of the repairs necessary to restore the property to its condition immediately before the injury.”<sup>10</sup> Sharyland contended that it was not seeking economic losses.<sup>11</sup> The Appellate Court disagreed, stating that “Sharyland seeks compensation only for economic damages including the cost associated with protecting, maintaining, and repairing its waterlines.”<sup>12</sup>

In ruling that the economic loss rule barred Sharyland's negligence claims against C&B, TCB, and Cris because Sharyland claimed economic damages but failed to claim and prove property damages, the Appellate Court noted as follows:

“Texas courts have applied the economic loss rule to preclude tort claims between parties who are not in contractual privity.” “‘Economic loss’ has been defined as ‘damages for inadequate value, costs of repair and replacement of the defective product, or consequent loss of profits—without any claim of personal injury or damage to other property....’” In tort cases where there is an absence of privity of contract or, as in this case, an absence of third-party beneficiary status, economic damages are not recoverable unless they are accompanied by actual physical injury or property damage. Thus, the threshold issue in this case is whether Sharyland suffered property damage, such that the economic loss rule will

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<sup>8</sup> See *id* at 141-42.

<sup>9</sup> See *id* at 153.

<sup>10</sup> See *id* at 153.

<sup>11</sup> See *id* at 153.

<sup>12</sup> See *id* at 155.

not bar its recovery.<sup>13</sup>

The Appellate Court held that “[b]ecause Sharyland has not identified any property damage that it has sustained as a result of the sewer line being laid above its waterlines, we conclude that the economic loss rule bars Sharyland’s negligence claim against C&B, TCB, and Cris, parties with which it is not in contractual privity.”<sup>14</sup>

### **SUMMARY OF THE ARGUMENT**

In ruling that the economic loss rule bars claims of negligence between parties who have no privity of contract where the damages at issue are economic in nature, the Appellate Court relied on flawed reasoning. If left undisturbed, the ruling will contribute to an increasing body of law, primarily from the Houston Court of Appeals and the Corpus Christi Court of Appeals, that may be used to work an injustice on potential claimants. Quite simply, where the parties are contractual strangers, the economic loss rule should not be found to apply.

Additionally, the Supreme Court should be cautious as to any ruling concerning the economic loss rule to avoid generalizations that may be wrongly applied to claims that operate as established exceptions to the economic loss rule—specifically, negligent misrepresentation.

### **ARGUMENT**

Generally, the economic loss rule is not considered an affirmative defense but rather a rule “for interpreting whether a party is barred from seeking damages in an action

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<sup>13</sup> *Id* at 152-53.

<sup>14</sup> *Id* at 155.

alleging tort injuries resulting from a contract between the parties.”<sup>15</sup> The economic loss rule: (1) bars recovery based on a negligence cause of action where the loss is the subject matter of a contract between the parties and (2) bars recovery of economic losses where the action is against the manufacturer or seller of a defective product where the defect results in damage only to the product and not to a person or to other property.<sup>16</sup>

## **I. THE ECONOMIC LOSS RULE SHOULD NOT BE APPLIED TO BAR NEGLIGENCE CLAIMS FOR ECONOMIC DAMAGES BETWEEN PARTIES WHO ARE NOT IN PRIVACY OF CONTRACT**

Whether or not the economic loss rule applies to situations in which there is no contractual privity is an issue the Texas Supreme Court has not expressly addressed. Federal courts interpreting Texas law have consistently determined that the economic loss rule does not apply where there is no contractual privity.<sup>17</sup> There appears to be an increasing trend in Texas cases, led by the Houston Court of Appeals and the Corpus Christi Court of Appeals, to apply the economic loss rule to negligence claims between parties who are not in contractual privity.<sup>18</sup> However, the very purpose of the economic

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<sup>15</sup> Tarrant County Hosp. Dist. v. GE Automation Servs., 156 S.W.3d 885, 895 (Tex. App.—Fort Worth 2005, no pet.).

<sup>16</sup> See Coastal Conduit & Ditching, Inc. v. Noram Energy Corp., 29 S.W.3d 282, 285-86 (Tex. App.—Houston [14<sup>th</sup> Dist.] 2000, no pet.).

<sup>17</sup> See Crawford Pharms. v. AmerisourceBergen Drug Corp., 2008 U.S. Dist. LEXIS 18666 (S.D. Tex. Mar. 11, 2008); see also Elk Corp. v. Valmet Sandy-Hill, Inc., 2000 U.S. Dist. LEXIS 3586 (N.D. Tex. Mar. 21, 2000); Jackson v. Dole Fresh Fruit Co., 921 F. Supp. 454, 458-59 (S.D. Tex. 1996); Juarez v. Chevron USA, Inc., 911 F. Supp. 257, 260 (S.D. Tex. 1995).

<sup>18</sup> See e.g. City of Alton v. Sharyland Water Supply Corp., 277 S.W.3d 132, 152 (Tex. App.—Corpus Christi 2009, pet. filed) (quoting Sterling Chems., Inc. v. Texaco Inc., 259 S.W.3d 793, 797 (Tex. App.—Houston [1st Dist.] 2007, pet. denied) (“Texas courts have applied the economic loss rule to preclude tort claims between parties who are not in contractual privity”); Sterling Chems. Inc. v. Texaco Inc., 259 S.W.3d 793, 797 (Tex. App.—Houston [1st Dist.] 2007, pet. denied) (citing Trans-Gulf Corp. v. Performance Aircraft Servs., Inc., 82 S.W.3d 691, 694-95 (Tex. App.—Eastland 2002, no pet.); Coastal Conduit & Ditching, Inc. v. Noram Energy Corp., 29 S.W.3d 282, 285-90 (Tex. App.—Houston [14<sup>th</sup> Dist.] 2000, no pet.); Hou-Tex Inc. v. Landmark Graphics, 26 S.W.3d 103, 106-07 (Tex. App.—Houston [14<sup>th</sup> Dist.] 2000, no pet.)) (“Texas courts have applied the economic loss rule to preclude tort claims between parties who are not in contractual privity”); Trans-Gulf Corp. v. Performance Aircraft Servs. Inc., 82 S.W.3d 691, 696 (Tex. App.—Eastland 2002, no pet.) (citing Coastal Conduit & Ditching Inc. v. Noram Energy Corp., 29 S.W.3d 282 (Tex. App.—Houston [14<sup>th</sup> Dist.] 2000, no pet.); Hou-Tex Inc. v. Landmark Graphics, 26

loss rule—barring recovery based on negligence where the loss is the subject matter of a contract *between the parties*—weighs in favor of not applying it to parties who are not in privity. The better rule is to apply the economic loss rule in negligence cases only where the parties are in privity of contract.

**A. Federal courts interpreting Texas law apply sound reasoning concerning the use of the economic loss rule to bar negligence claims for economic damages between parties who are not in privity of contract**

Federal courts interpreting Texas law have often determined that the economic loss rule does not apply where there is no contractual privity. The cases discussed below are illustrative. In *Crawford Pharms. v. AmerisourceBergen Drug Corp.*, the United States District Court for the Southern District of Texas stated:

Federal Courts applying the economic loss rule have consistently held that the rule does not apply in the absence of contractual privity. Texas appellate courts, on the other hand, are divided with respect to whether or not contractual privity is required. And the Texas Supreme Court has not ruled with respect to whether or not contractual privity is necessary. In light of this divergent case law, the Court finds that there is ““a reasonable basis for predicting that state law might impose liability.””<sup>19</sup>

The court noted that the possibility existed that the economic loss rule did not preclude

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S.W.3d 103 (Tex. App.—Houston [14th Dist.] 2000, no pet.) (“Performance and Associated are contractual strangers with Trans-Gulf. Furthermore, Trans-Gulf only seeks to recover economic damages. We agree with the holdings of *Coastal Conduit, Hou-Tex*, and the majority of other courts which have considered this issue. Simply stated, a duty in tort does not lie under the economic loss rule when the only injury claimed is one for economic damages”); *Coastal Conduit & Ditching Inc. v. Noram Energy Corp.*, 29 S.W.3d 282, 285-89 (Tex. App.—Houston [14th Dist.] 2000, no pet.) (determining that Texas law precludes the recovery of economic damages in a negligence case where the parties are contractual strangers and there is no accompanying claim for damages to a person or property); *Hou-Tex Inc. v. Landmark Graphics*, 26 S.W.3d 103, 107 (Tex. App.—Houston [14th Dist.] 2000, no pet.) (holding that permitting a party not in privity with the other party to maintain tort claims against the other party when there was no privity of contract would disrupt the contractual risk allocations amongst various other parties).

<sup>19</sup> *Crawford Pharms. v. AmerisourceBergen Drug Corp.*, 2008 U.S. Dist. LEXIS 18666, \*10-11 (S.D. Tex. Mar. 11, 2008) (internal citations omitted).

the plaintiff's negligent misrepresentation claim against the defendant.<sup>20</sup> While the case discusses the application of the economic loss rule to a negligent misrepresentation claim—an issue discussed in greater detail below—the quote above illustrates the lack of clarity in Texas law in applying the economic loss rule in the absence of contractual privity.

In *Elk Corp. v. Valmet Sandy-Hill Inc.*, the plaintiff did not allege any physical injury to its property but sought economic damages on its claim for negligence.<sup>21</sup> The defendant argued that because the plaintiff's claims did not include an allegation of physical injury, they are precisely the type of claims prohibited by the economic loss doctrine.<sup>22</sup> The court noted that “Texas law does not recognize a negligence claim for purely economic loss” and that “unintentional conduct that causes economic harm unaccompanied by physical injury—to person or property—does not serve as a basis for a recovery in tort.”<sup>23</sup> But the court also noted that Texas courts “have never applied the economic loss doctrine to a plaintiff's claims in the absence of contractual privity between the plaintiff and a defendant.”<sup>24</sup> In ruling that the plaintiff was not fraudulently joined, the court expressed the concern that it is problematic to say that the plaintiff's injury is only economic loss that is the subject of a contract or that the plaintiff's damages were entirely contractual in nature when the alleged tortfeasors were not parties to the

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<sup>20</sup> See *Crawford*, 2008 U.S. Dist. LEXIS 18666 at \*11-12.

<sup>21</sup> See *Elk Corp. v. Valmet Sandy-Hill Inc.*, 2000 U.S. Dist. LEXIS 3586, \*7-8 (N.D. Tex. Mar. 21, 2000).

<sup>22</sup> See *Elk Corp.*, 2000 U.S. Dist. LEXIS 3586 at \*8.

<sup>23</sup> *Elk Corp.*, 2000 U.S. Dist. LEXIS 3586 at \*7.

<sup>24</sup> *Elk Corp.*, 2000 U.S. Dist. LEXIS 3586 at \*9.

contract.<sup>25</sup>

In *Jackson v. Dole Fresh Fruit Co.*, the plaintiffs brought a conspiracy claim against the defendants based on a conspiracy to interfere with a contract.<sup>26</sup> Relying on the economic loss rule, the defendants argued that the only claim the plaintiffs had was for breach of contract and that breach of a contractual duty cannot give rise to a tort claim.<sup>27</sup> The court held that the economic loss rule was clearly inapplicable to the plaintiffs' tortious interference claim against one defendant as there was no contract between that defendant and the plaintiffs and it could "hardly be said that the duty [the defendant] allegedly breached arose from a contract."<sup>28</sup> Although *Jackson* discusses a conspiracy and tortious interference claim, the concerns regarding applying the economic loss rule where there is no privity of contract are pertinent.

In *Juarez v. Chevron USA Inc.*, the plaintiffs' claims against the defendants were for fraud and fraudulent concealment.<sup>29</sup> The court described the claims as follows:

Defendants emphasize that the only injury allegedly resulting from Lange's and Hunter's actions is the gas lost to drainage, which is the same injury resulting from Chevron's breach of the implied covenant to prevent drainage. Likewise, Plaintiffs' damages for fraud are the same as those for the breach of the implied covenant—the value of the gas drained. Because Plaintiffs have failed to allege injury and damages attributable solely to the alleged fraud, the argument goes, this claim sounds entirely in contract and not in tort.<sup>30</sup>

In ruling that the defendants' arguments failed, the court noted that the defendants were

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<sup>25</sup> See *Elk Corp.*, 2000 U.S. Dist. LEXIS 3586 at \*9.

<sup>26</sup> See *Jackson v. Dole Fresh Fruit Co.*, 921 F. Supp. 454, 457 (S.D. Tex. 1996).

<sup>27</sup> See *Jackson*, 921 F. Supp. at 459.

<sup>28</sup> *Jackson*, 921 F. Supp. at 459.

<sup>29</sup> See *Juarez v. Chevron USA*, 911 F. Supp. 257, 259 (S.D. Tex. 1995).

<sup>30</sup> *Juarez*, 911 F. Supp. at 260.

not parties to a contract with the plaintiffs.<sup>31</sup> As in *Elk Corp.*, the court noted that it is problematic to say that the plaintiffs' injury is only the "economic loss to the subject of the contract" or that the plaintiffs' damages are entirely contractual in nature when the alleged tortfeasors were not parties to the applicable contract.<sup>32</sup> Again, the concerns regarding applying the economic loss rule where there is no privity of contract are pertinent.

**B. The potential disruption of contractual risk allocations is not a valid reason for using the economic loss rule to bar negligence claims for economic damages between parties who are not in privity of contract**

The Houston Court of Appeals has justified applying the economic loss rule to bar claims by one party against another party with whom it is not in privity on the grounds that allowing that party to sue for economic damages would disrupt the risk allocations that the other party bargained for in its contracts.<sup>33</sup> This rationale is unpersuasive and can bar valid claims as some risks cannot be addressed contractually. For example, governmental immunity or bankruptcy may make maintaining a breach of contract claim against a party impossible.

The following hypothetical illustrates the problem. Assume that Designer has a contract with Owner to provide design criteria for a construction project. Under that contract, Designer is to provide the criteria to Owner. Owner has a contract with Contractor for the actual construction of the project. Under that contract, Contractor is to follow the design criteria provided to Owner by Designer. Designer and Contractor are

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<sup>31</sup> See *Juarez*, 911 F. Supp. at 260.

<sup>32</sup> See *Juarez*, 911 F. Supp. at 260.

<sup>33</sup> See *Sterling Chems. Inc. v. Texaco Inc.*, 259 S.W.3d 793, 800 (Tex. App.—Houston [1st Dist.] 2007, pet. denied); *Hou-Tex Inc. v. Landmark Graphics*, 26 S.W.3d 103, 107 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

linked only by separate contracts with Owner—there is no privity of contract between Designer and Contractor. Should the design criteria be inaccurate resulting in Contractor incurring increased home office overhead expenses (economic damages), Contractor may perhaps maintain a breach of contract action against Owner, although Designer should be ultimately responsible for its inaccurate design criteria and any resulting damages. If Owner is bankrupt<sup>34</sup> or immune from suit,<sup>35</sup> Contractor likely has only the ability to assert tort claims against Designer—a party with whom Contractor has no privity. If the economic loss rule applies in situations such as this, Contractor is left with no recourse for its damages and Designer, the party ultimately responsible for causing Contractor to incur damages, escapes liability altogether. Such an application of the economic loss rule is grossly unfair and goes far beyond barring tort claims where there is a contract between the actual parties. The risk allocation argument is simply not persuasive as other factors may be at work that require that a negligence claim be asserted against a party.

**C. Legal duties can exist that make applying the economic loss rule to bar negligence claims for economic damages between parties who are not in privity of contract improper**

As for duties under the common law, the Texas Supreme Court has held that “one who voluntarily undertakes an affirmative course of action for the benefit of another has a duty to exercise reasonable care that the other’s person or property will not be injured thereby.”<sup>36</sup> This duty of care has evolved to include the protection of third parties.<sup>37</sup> In

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<sup>34</sup> See e.g. 11 U.S.C. §§101-1532.

<sup>35</sup> See e.g. Tex. Loc. Gov’t Code §271.153(b) (2008).

<sup>36</sup> Fort Bend County Drainage Dist. v. Sbrusch, 818 S.W.2d 392, 395 (Tex. 1991) (citing Colonial Sav. Ass’n v. Taylor, 544 S.W.2d 116, 119 (Tex. 1976)); see also Otis Engineering Corp. v. Clark, 668 S.W.2d 307, 309 (Tex. 1983).

<sup>37</sup> See Restatement (Second) of Torts §324A (1965).

other words, a person may owe a duty of care to a third party simply by embarking upon an undertaking for another.<sup>38</sup> Section 324A of the Restatement (Second) of Torts, which sets forth this duty, provides as follows:

§ 324A Liability to Third Person for Negligent Performance of Undertaking

One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to protect his undertaking, if

- (a) his failure to exercise reasonable care increases the risk of such harm, or
- (b) he has undertaken to perform a duty owed by the other to the third person, or
- (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.<sup>39</sup>

Texas courts have expressly recognized Section 324A of the Restatement (Second) of Torts as governing law.<sup>40</sup> Ultimately, imposing a duty of reasonable care when undertaking services that will be relied on by a third party establishes an actionable claim for negligence, although courts have discussed the issues in terms of a cause of action for

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<sup>38</sup> See *Torrington Co. v. Stutzman*, 46 S.W.3d 829, 837 (Tex. 2000) (citing *Fort Bend County Drainage Dist.*, 818 S.W.2d at 396; *Colonial Sav. Ass'n*, 544 S.W.2d at 120; Restatement (Second) of Torts §§ 323, 324A (1965)) (stating that “[w]hile Texas law imposes no general duty to ‘become [a] good Samaritan,’ we have recognized that a duty to use reasonable care may arise when a person undertakes to provide services to another, either gratuitously or for compensation”); *Bernard Johnson Inc. v. Continental Constructors Inc.*, 630 S.W.2d 365, 375 n.10 (Tex. App.—Austin 1982, no writ) (recognizing that Section 324A may impose liability for physical harm suffered by a third person when the actor undertakes to render services for another).

<sup>39</sup> Restatement (Second) of Torts §324A (1965).

<sup>40</sup> See *Fort Bend County Drainage Dist. v. Sbrusch*, 818 S.W.2d 392, 396 (Tex. 1991); *Denton v. Van Page*, 701 S.W.2d 831, 835 (Tex. 1986) (Kilgarlin, J., concurring); *Builders Transp. Inc. v. Grice-Smith*, 167 S.W.3d 1, 10 (Tex. App.—Waco 2005, no pet.); *Coastal Corp. v. Torres*, 133 S.W.3d 776, 780 n.5 (Tex. App.—Corpus Christi 2004, pet. denied); *Olivas v. Southwest Royalties Holdings Inc.*, 2003 Tex. App. LEXIS 6894 (Tex. App.—El Paso Aug. 12, 2003, pet. denied); *Steward v. Costello*, 2003 Tex. App. LEXIS 248 (Tex. App.—Dallas Jan. 14, 2003, no pet.); *Banzhaf v. ADT Sec. Sys. Southwest Inc.*, 28 S.W.3d 180, 186 (Tex. App.—Eastland 2000, pet. denied); *Abdel-Fattah v. Pepsico Inc.*, 948 S.W.2d 381, 385 (Tex. App.—Houston [14th Dist.] 1997, no writ); *Rao v. Rodriguez*, 923 S.W.2d 176, 180 (Tex. App.—Beaumont 1996, no writ); *Seay v. Travelers Indem. Co.*, 730 S.W.2d 774, 775-77 (Tex. App.—Dallas 1987, no writ).

“negligent undertaking.” Although Section 324A speaks in terms of recovering damages for physical harm, this restriction may arguably be expanded to include economic damages.<sup>41</sup>

Additionally, duties may be established by statutes or by administrative rules. For example, an architect is required to perform his or her services “with reasonable care and competence and shall apply the technical knowledge and skill which is ordinarily applied by reasonably prudent architects practicing under similar circumstances and conditions.”<sup>42</sup> There is no valid reason why a person who suffers economic damages by virtue of an architect’s wrongful acts or omissions should not be able to maintain a cause of action in tort if the person is not a party to a contract with the architect. The same is true where other duties are imposed by statutes or by administrative rules.

#### **D. Conclusion**

The economic loss rule as used today may prevent a person from recovering economic damages related to another’s negligent acts or omissions. But the better rule is

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<sup>41</sup> See *Peterson v. Mutual Sav. Institution*, 646 S.W.2d 327, 329 (Tex. App.—Austin 1983, no writ) (discussing Section 323 of the Restatement (Second) of Torts, which concerns the negligent performance of an undertaking to render services, and recognizing that it “has been applied to cases involving only economic injury...”); *Bernard Johnson Inc. v. Continental Constructors Inc.*, 630 S.W.2d 365, 375 (Tex. App.—Austin 1982, no writ) (“[b]y analogy, we suppose, some courts have allowed recovery under the theory of the Restatement in cases involving economic injury and not physical harm.... We are not informed by the *Taylor* opinion whether the relevant cause of action encompasses economic injury”); *Charles E. Beard Inc. v. McDonnell Douglas Corp.*, 939 F.2d 280, 283 (5th Cir. 1991) (“[a]lthough the plain language of the Restatement limits liability to cases of physical harm, some Texas courts have indicated that the rule may have a broader application”); *Hernandez v. Ciba-Geigy Corp. USA*, 200 F.R.D. 285, 296 (S.D. Tex. 2001) (“[a]lthough the rule of the Restatement requires that the plaintiff suffer physical harm, it has also been applied to cases involving economic injury if the undertaking is pursued for the benefit of the injured person”); see also *Renteria v. United States*, 452 F. Supp. 2d 910 (D. Ariz. 2006) (holding that the Good Samaritan Doctrine set forth in Section 323 of the Restatement is applicable to economic harm as well as physical harm); *Kentucky Laborers Dist. Council Health & Welfare Trust Fund v. Hill & Knowlton*, 24 F. Supp. 2d 755, 774 (W.D. Ky. 1998) (“[b]oth sections also impose liability only for physical harm, though there appears to be at least one Kentucky case permitting recovery for a breach of an assumed duty resulting only in economic harm”); *Caldwell v. Philadelphia*, 358 Pa. Super. 406, 426 (Pa. Super. Ct. 1986) (Hoffman, J., dissenting) (“[c]ourts in other jurisdictions, applying § 323, have permitted recovery for other than physical harm”).

<sup>42</sup> 22 Tex. Admin. Code. Rule §1.142(a).

to allow the recovery of economic damages in a claim for negligence where the parties are not in contractual privity. By preventing the effectiveness of a negligence claim for economic damages where there is no privity of contract, the economic loss rule can simply lead to inequitable results. This risk is not outweighed by the benefits of its application, if there are any. Applying the economic loss rule where the parties are in contractual privity may make sense. Applying it where there is no contractual privity does not. The law may place a duty on a person, be it through the common law or statutes or rules, to act pursuant to a certain standard. When a person breaches that duty and another person suffers economic damages, there is no logic in preventing the injured person from maintaining an action in tort against negligent person.

**II. CAUTION SHOULD BE EXERCISED TO AVOID GENERALIZATIONS THAT MAY BE WRONGLY APPLIED TO OTHER CLAIMS THAT OPERATE AS EXCEPTIONS TO THE ECONOMIC LOSS RULE**

Although Sharyland does not appear to have asserted a claim for negligent misrepresentation, the Court should be cautious when addressing matters concerning the economic loss to avoid any unintentional generalizations that may be wrongly applied. A few of the cases discussed above, and cited in the Appellate Court's opinion, touch on the application of the economic loss rule to claims for negligent misrepresentation. There are conflicting opinions on the matter by various courts. While this particular case may not be the appropriate case to address these issues, the Court should be cognizant of the issues surrounding the application of the economic loss rule to claims for negligent misrepresentation.

**A. The elements of negligent misrepresentation under Sections 552 and 552B of the Restatement (Second) of Torts and the economic loss rule**

As addressed in detail below, Texas courts have consistently allowed parties to pursue or recover economic damages based on a claim for negligent misrepresentation. Negligent misrepresentation requires proof of the following elements: (1) the representation is made by a defendant in the course of his business or in a transaction in which he has a pecuniary interest; (2) the defendant supplies “false information” for the guidance of others in their business; (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffers pecuniary loss by justifiably relying on the representation.<sup>43</sup> The Texas Supreme Court has recognized that Sections 552 and 552B of the Restatement (Second) of Torts provide the elements for negligent misrepresentation and establish the type of recovery available.<sup>44</sup>

In establishing the elements of negligent misrepresentation, the Texas Supreme Court relied on Section 552 of the Restatement (Second) of Torts.<sup>45</sup> That section states as follows:

§ 552 Information Negligently Supplied for the Guidance of Others

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or

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<sup>43</sup> See *Federal Land Bank Ass’n v. Sloane*, 825 S.W.2d 439, 442 (Tex. 1991).

<sup>44</sup> See *Federal Land Bank*, 825 S.W.2d at 442; *D.S.A. Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 663 (Tex. 1998).

<sup>45</sup> See *Federal Land Bank*, 825 S.W.2d at 442.

competence in obtaining or communicating the information.

(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.<sup>46</sup>

Section 552 of the Restatement (Second) of Torts “imposes a duty to avoid negligent misrepresentation, irrespective of privity.”<sup>47</sup> Liability for negligent misrepresentation “is not based on the breach of duty a professional owes his or her clients or others in privity, but on an independent duty to the nonclient based on the professional’s manifest awareness of the nonclient’s reliance on the misrepresentation and the professional’s intention that the nonclient so rely.”<sup>48</sup> Thus, a cause of action for negligent misrepresentation allows a person to recover damages from a professional even when that person is not a party to a contract for professional services.<sup>49</sup> A claim of negligent misrepresentation has been found to be a valid cause of action as to a variety of professional services, including but not necessarily limited to the services provided by

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<sup>46</sup> Restatement (Second) of Torts §552 (1977).

<sup>47</sup> *McCamish v. F. E. Appling Interests*, 991 S.W.2d 787, 792 (Tex. 1999).

<sup>48</sup> *McCamish*, 991 S.W.2d at 792 (citing *Horizon Fin., F.A. v. Hansen*, 791 F. Supp. 1561, 1574 (N.D. Ga. 1992)).

<sup>49</sup> See *McCamish*, 991 S.W.2d at 792; *Belt v. Oppenheimer, Blend, Harrison & Tate Inc.*, 192 S.W.3d 780, 788 (Tex. 2006); *Prospect High Income Fund v. Grant Thornton, LLP*, 203 S.W.3d 602, 615 (Tex. App.—Dallas 2006, pet. denied); *J.M.K. 6 Inc. v. Gregg & Gregg P.C.*, 192 S.W.3d 189, 203 (Tex. App.—Houston [14th Dist.] 2006, no pet.); *Wright v. Sydow*, 173 S.W.3d 534, 554 (Tex. App.—Houston [14th Dist.] 2004, pet. denied).

attorneys, auditors, physicians, real-estate brokers, securities placement agents, accountants, surveyors, and title insurers.<sup>50</sup> Section 552 allows for the recovery of “pecuniary loss” caused by justifiable reliance on a negligent misrepresentation.<sup>51</sup>

In establishing the types of damages recoverable on a negligent misrepresentation claim, the Texas Supreme Court relied on Section 552B of the Restatement (Second) of Torts.<sup>52</sup> In order to recover under a claim for negligent misrepresentation, a plaintiff must satisfy the independent injury requirement set forth in Section 552B of the Restatement (Second) of Torts.<sup>53</sup> That section states as follows:

#### § 552B Damages for Negligent Misrepresentation

(1) The damages recoverable for a negligent misrepresentation are those necessary to compensate the plaintiff for the pecuniary loss to him of which the misrepresentation is a legal cause, including

(a) the difference between the value of what he has received in the transaction and its purchase price or other value given for it; and

(b) pecuniary loss suffered otherwise as a consequence of the plaintiff’s reliance upon the misrepresentation.

(2) the damages recoverable for a negligent misrepresentation do not include the benefit of the plaintiff’s contract with the defendant.<sup>54</sup>

The economic loss rule is also known as the independent injury doctrine.<sup>55</sup> This

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<sup>50</sup> See *McCamish*, 991 S.W.2d at 791; see also *Abrams Ctr. Nat’l Bank v. Farmer, Fuqua & Huff, P.C.*, 225 S.W.3d 171, 177 (Tex. App.—El Paso 2005, no pet.).

<sup>51</sup> Restatement (Second) of Torts §552(1) (1977).

<sup>52</sup> See *Federal Land Bank*, 825 S.W.2d at 442-43.

<sup>53</sup> See *Federal Land Bank*, 825 S.W.2d at 442; *D.S.A. Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 663 (Tex. 1998).

<sup>54</sup> Restatement (Second) of Torts §552B (1977).

<sup>55</sup> See *Cardinal Health Solutions, Inc. v. Valley Baptist Med. Ctr.*, 2009 U.S. Dist. LEXIS 3909 \*15 n.5 (S.D. Tex. Jan. 21, 2009); *Highland Crusader Offshore Partners. L.P. v. LifeCare Holdings, Inc.*, 2008 U.S. Dist. LEXIS 66229 \*44 (N.D. Tex. Aug. 27, 2008); *Regus Mgmt. Group, LLC v. IBM*, 2008 U.S. Dist. LEXIS 33807 \*18 (N.D. Tex. Apr. 24, 2008).

independent injury requirement in Section 552B of the Restatement (Second) of Torts essentially embodies the economic loss rule as it was intended to apply—only where there is a contract between the parties.

Section 552B provides that the recoverable damages for negligent misrepresentation include “pecuniary loss suffered otherwise as a consequence of the plaintiff’s reliance upon the misrepresentation.”<sup>56</sup> Losses that are pecuniary in nature are the same as damages that are economic in nature.<sup>57</sup> There is no functional distinction between the terms “pecuniary” and “economic.”

**B. As shown by the Texas Supreme Court and Texas appellate courts, negligent misrepresentation is an exception to the economic loss rule**

The Texas Supreme Court has allowed for the recovery of economic losses when presented with a claim for negligent misrepresentation from a claimant not in privity with the defending party.<sup>58</sup> Texas appellate courts have also allowed for the potential recovery of economic losses under a claim for negligent misrepresentation where contractual privity did not exist.<sup>59</sup> Basically, the recovery of economic damages in a claim for negligent misrepresentation when the parties are not in privity is a *de facto* exception to the economic loss rule, which has been recognized by the Texas Supreme Court and numerous Texas appellate courts. To apply the economic loss rule in negligent

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<sup>56</sup> Restatement (Second) of Torts §552B(1)(b) (1977).

<sup>57</sup> See Tex. Civ. Prac. & Rem. Code §41.001(4) (2008); Tex. Bus. & Com. Code §17.45(11) (2008); Moore v. Lillebo, 722 S.W.2d 683, 687 (Tex. 1986).

<sup>58</sup> See McCamish v. F. E. Appling Interests, 991 S.W.2d 787, 794 (Tex. 1999); see also Belt v. Oppenheimer Blend Harrison & Tate Inc., 192 S.W.3d 780, 788 (Tex. 2006).

<sup>59</sup> See Ervin v. Mann Frankfort Stein & Lipp CPAS LLP, 234 S.W.3d 172, 174-82 (Tex. App.—San Antonio 2007, no pet.); Peters v. Norwegian Cruise Line Ltd., 2007 Tex. App. LEXIS 4461 (Tex. App.—Houston [1st Dist.] 2007, no pet.); Lyda Constructors Inc. v. Butler Mfg. Co., 103 S.W.3d 632, 639 (Tex. App.—San Antonio 2003, no pet.); Cook Consultants Inc. v. Larson, 700 S.W.2d 231, 233-38 (Tex. App.—Dallas 1985, no writ).

misrepresentation cases where the parties are not in privity essentially destroys an entire cause of action, which has been established by the Texas Supreme Court and consistently held to be valid, and effectively leaves many parties suffering pecuniary losses due to a misrepresentation with no remedy.

**i. *Texas Supreme Court***

In *McCamish v. F. E. Appling Interests*, the issue before the Texas Supreme Court was whether a nonclient could bring a negligent misrepresentation cause of action, as defined by section 552 of the Restatement (Second) Torts, against a law firm.<sup>60</sup> In that case, a developer filed a suit against a law firm with whom it was not in contractual privity and alleged that the law firm negligently misrepresented information.<sup>61</sup> Economic damages appear to be the only damages at issue in the case.<sup>62</sup> The Texas Supreme Court acknowledged that it had previously adopted the tort of negligent misrepresentation as described by Section 552 of the Restatement (Second) Torts.<sup>63</sup> In applying a negligent misrepresentation claim to attorneys, the Texas Supreme Court noted that other Texas courts have recognized a section 552 cause of action for negligent misrepresentation against other professionals as well, including auditors, physicians, real-estate brokers, securities placement agents, accountants, surveyors, and title insurers.<sup>64</sup> The court described the purpose of a negligent misrepresentation and the issues of privity as follows:

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<sup>60</sup> See *McCamish v. F. E. Appling Interests*, 991 S.W.2d 787, 791 (Tex. 1999).

<sup>61</sup> See *McCamish*, 991 S.W.2d at 790.

<sup>62</sup> See *McCamish*, 991 S.W.2d at 789-90.

<sup>63</sup> See *McCamish*, 991 S.W.2d at 791.

<sup>64</sup> See *McCamish*, 991 S.W.2d at 791.

Under the tort of negligent misrepresentation, liability is not based on the breach of duty a professional owes his or her clients or others in privity, but on an independent duty to the nonclient based on the professional's manifest awareness of the nonclient's reliance on the misrepresentation and the professional's intention that the nonclient so rely. The theory of negligent misrepresentation permits plaintiffs who are not parties to a contract for professional services to recover from the contracting professionals. Likewise, section 552 imposes a duty to avoid negligent misrepresentation, irrespective of privity. Section 552 is the most widely adopted standard of negligent misrepresentation in attorney liability cases and economic negligence cases generally.<sup>65</sup>

The ultimate holding in *McCamish v. F. E. Appling Interests*, is that a party may maintain a claim for negligent misrepresentation for economic damages against someone with whom the party is not in privity.<sup>66</sup> In 2006, the Texas Supreme Court again recognized this holding when it expressly stated that “we have allowed non-clients to maintain negligent misrepresentation suits against attorneys despite a lack of privity.”<sup>67</sup>

## ii. *Texas appellate courts*

Texas appellate courts have also allowed parties to pursue or recover economic damages based on a claim for negligent misrepresentation where contractual privity did not exist. Some examples are discussed below.

In *Ervin v. Mann Frankfort Stein & Lipp CPAS L.L.P.*, the plaintiffs brought claims for negligent misrepresentation and professional negligence against an accounting firm.<sup>68</sup> The plaintiffs had participated as investors in the buyout of a business and the accounting firm had been retained by others to perform an audit and other accounting

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<sup>65</sup> *McCamish*, 991 S.W.2d at 792 (internal citations omitted).

<sup>66</sup> See *McCamish*, 991 S.W.2d at 795.

<sup>67</sup> *Belt v. Oppenheimer, Blend, Harrison & Tate, Inc.*, 192 S.W.3d 780, 788 (Tex. 2006).

<sup>68</sup> See *Ervin v. Mann Frankfort Stein & Lipp CPAS LLP*, 234 S.W.3d 172, 174 (Tex. App.—San Antonio 2007, no pet.).

services.<sup>69</sup> After the buyout, it became evident that the accounting firm had failed to discover a \$5,000,000 liability.<sup>70</sup> The plaintiffs claimed that the accounting firm failed to discover this alleged impropriety and report it to the investors, which resulted in the loss of the plaintiffs' \$3,600,000 investment.<sup>71</sup> The trial court granted summary judgment in favor of the accounting firm.<sup>72</sup> The San Antonio Court of Appeals noted that:

A negligent misrepresentation claim is not the equivalent of a professional malpractice or negligence claim. Unlike a professional malpractice or negligence claim, liability is not based on a breach of duty a professional owes a client or others in privity. Rather, liability is based on the professional's "manifest awareness" of the non-client's reliance and the professional's intention that the non-client rely on the professional's representations. Thus, an accountant can be subject to a negligent misrepresentation claim when he is not subject to a professional negligence claim. Accordingly, in determining whether a claim for negligent misrepresentation is viable against a professional, we look not to rules governing the existence of privity; rather, we look to section 552 of the Restatement (Second) of Torts....<sup>73</sup>

In *Peters v. Norwegian Cruise Line Ltd.*, the plaintiff, who was disabled and required a wheelchair, went on a cruise based on a travel agent's representations that the cruise ship would be able to accommodate his wheelchair.<sup>74</sup> Neither the ship itself nor the ports of call visited were able to fully accommodate his wheelchair.<sup>75</sup> Similar issues arose on a subsequent cruise.<sup>76</sup> The plaintiff brought numerous claims, including negligent misrepresentation, against the cruise line and sought economic damages—the purchase

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<sup>69</sup> See *Ervin*, 234 S.W.3d at 174-75.

<sup>70</sup> See *Ervin*, 234 S.W.3d at 175.

<sup>71</sup> See *Ervin*, 234 S.W.3d at 175-76.

<sup>72</sup> See *Ervin*, 234 S.W.3d at 176.

<sup>73</sup> *Ervin*, 234 S.W.3d at 176-77 (internal citations omitted).

<sup>74</sup> See *Peters v. Norwegian Cruise Line Ltd.*, 2007 Tex. App. LEXIS 4461, \*2-5 (Tex. App.—Houston [1st Dist.] 2007, no pet.).

<sup>75</sup> See *Peters*, 2007 Tex. App. LEXIS 4461 at \*4-5.

<sup>76</sup> See *Peters*, 2007 Tex. App. LEXIS 4461 at \*5-7.

price of the tickets and his lost vacation time he used to take the cruises.<sup>77</sup> The trial court granted summary judgment in favor of the cruise line.<sup>78</sup> The appellate court noted that although the cruise line did not make the alleged misrepresentations directly to the plaintiff, a party may be liable for a misrepresentation made indirectly to a third person “if the person making the misrepresentation had intent or knowledge that it should be exhibited or repeated to a third person and intended or had reason to expect the third person would act or refrain from acting in reliance upon the misrepresentation.”<sup>79</sup> The appellate court reversed the ruling of the trial court.<sup>80</sup> The *Peters* case is yet another example of negligent misrepresentation being appropriately used as a tort to recover economic damages.

*Lyda Constructors Inc. v. Butler Mfg. Co.* involved a dispute between a general contractor and a remote supplier, with whom the general contractor was not in privity, over project delay damages allegedly caused by the supplier.<sup>81</sup> The subcontractor who was in privity with the supplier failed to pay the supplier for delivered materials.<sup>82</sup> The supplier filed suit against the surety and the general contractor intervened, alleging that the supplier caused the general contractor delay damages by failing to deliver the supplies timely and failing to deliver supplies complying with the project’s design specifications.<sup>83</sup> The trial court granted summary judgment to the supplier as to all of the general contractor’s claims, including the general contractor’s claim for negligent

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<sup>77</sup> See *Peters*, 2007 Tex. App. LEXIS 4461 at \*1, 21.

<sup>78</sup> See *Peters*, 2007 Tex. App. LEXIS 4461 at \*7.

<sup>79</sup> *Peters*, 2007 Tex. App. LEXIS 4461 at \*14-16 n.5.

<sup>80</sup> See *Peters*, 2007 Tex. App. LEXIS 4461 at \*47.

<sup>81</sup> See *Lyda Constructors Inc. v. Butler Mfg. Co.*, 103 S.W.3d 632, 639 (Tex. App.—San Antonio 2003, no pet.).

<sup>82</sup> See *Lyda*, 103 S.W.3d at 635.

<sup>83</sup> See *Lyda*, 103 S.W.3d at 635.

misrepresentation.<sup>84</sup> The appellate court noted that there was some evidence for each of the elements of negligent misrepresentation and that the general contractor was seeking recoverable damages from the supplier.<sup>85</sup> The supplier contended that it was not liable for the delay damages sought by the general contractor because they were “benefit-of-the-bargain damages” that the subcontractor agreed to assume responsibility for and which were not, in any event, available on a claim of negligent misrepresentation.<sup>86</sup> The court expressly noted that the general contractor had no contract with the supplier and that “there was thus no bargain from which to benefit.”<sup>87</sup> Importantly, the court recognized that the general contractor’s claim of delay damages against the supplier was independent of any liability for delay that may have been assumed by the subcontractor.<sup>88</sup> The *Lyda* case shows that a contractor may properly assert a claim for negligent misrepresentation seeking delay damages against a third party.

In *Cook Consultants Inc. v. Larson*, a surveyor appealed from a judgment against it arguing, in part, it owed no duty to a homebuyer absent privity of contract.<sup>89</sup> A residential developer had contracted with the surveyor to locate all improvements on a lot.<sup>90</sup> The survey indicated that the home had been constructed within the lot lines.<sup>91</sup> The homebuyer then purchased the property.<sup>92</sup> It was then discovered that the home actually encroached on a neighbor’s property and the home was entirely demolished to comply

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<sup>84</sup> See *Lyda*, 103 S.W.3d at 635.

<sup>85</sup> See *Lyda*, 103 S.W.3d at 638-39.

<sup>86</sup> See *Lyda*, 103 S.W.3d at 639.

<sup>87</sup> *Lyda*, 103 S.W.3d at 639.

<sup>88</sup> See *Lyda*, 103 S.W.3d at 639.

<sup>89</sup> See *Cook Consultants Inc. v. Larson*, 700 S.W.2d 231, 233 (Tex. App.—Dallas 1985, no writ).

<sup>90</sup> See *Cook*, 700 S.W.2d at 233.

<sup>91</sup> See *Cook*, 700 S.W.2d at 233.

<sup>92</sup> See *Cook*, 700 S.W.2d at 233.

with a court order.<sup>93</sup> The homebuyer sought the diminished value of the property as her measure of damages and the court recognized this as the proper measure of damages.<sup>94</sup> Referring to Section 552 of the Restatement (Second) of Torts, the court recognized that the surveyor—even though it had no contract with the homebuyer—owed the homebuyer a common law duty of care.<sup>95</sup> Recognizing that the Restatement itself imposes limits on the types of recovery available, the court noted that “Section 552 ‘realistically recognizes that business [persons] who justifiably rely on the advice and expertise of other business [persons], holding themselves out in the community as possessing unique skills, are entitled to expect that one possessing skill will exercise it with due care in the course of his [or her] business relationships.’”<sup>96</sup> The court stated that it is proper to limit liability to the person or class of persons whom the maker of the representation intends to benefit or who foreseeably may be expected to rely on the information.<sup>97</sup> Quoting the Restatement, the court recognized that limited liability promotes a “social policy of encouraging the flow of commercial information upon which the operation of the economy rests” that will not unreasonably burden a surveyor’s business.<sup>98</sup> *Cook* is yet another example of courts allowing a claim for negligent misrepresentation to be asserted to recover economic damages even though there is a contract between other parties.

### iii. *Distinguishable cases*

Certain Texas appellate courts, some of which are cited in the Appellate Court’s

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<sup>93</sup> See *Cook*, 700 S.W.2d at 233.

<sup>94</sup> See *Cook*, 700 S.W.2d at 237-38.

<sup>95</sup> See *Cook*, 700 S.W.2d at 233-34.

<sup>96</sup> *Cook*, 700 S.W.2d at 234.

<sup>97</sup> See *Cook*, 700 S.W.2d at 234.

<sup>98</sup> *Cook*, 700 S.W.2d at 234-35.

opinion, have held that the economic loss rule can be used to preclude the recovery of economic damages in negligence cases where the parties are contractual strangers and there is no accompanying claim for damages to a person or property. But these cases are either distinguishable or improperly decided as to a claim for negligent misrepresentation.

In *Trans-Gulf Corp. v. Performance Aircraft Servs.*, the Eastland Court of Appeals did address negligent misrepresentation and the economic loss rule. But it did not discuss the issues together. The court held that the economic loss rule barred the plaintiff's negligence and negligence per se claims.<sup>99</sup> As to negligent misrepresentation, the court held that the plaintiff was not within the limited group of persons who can assert a claim for negligent misrepresentation under Section 552 of the Restatement (Second) of Torts.<sup>100</sup> The court did not discuss the applicability of the economic loss rule to negligent misrepresentation claims.

The issue in *Coastal Conduit & Ditching Inc. v. Noram Energy Corp.* was whether the recovery of economic damages is precluded in a negligence case where the parties are contractual strangers and there is no accompanying claim for damages to a person or property.<sup>101</sup> There was no contractual relationship between the plaintiff and the defendant and no claim for personal injury or property damage.<sup>102</sup> The court held that in the absence of privity of contract and where there is no accompanying personal injury or property damage, a plaintiff cannot recover for purely economic losses resulting from another's

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<sup>99</sup> See *Trans-Gulf Corp. v. Performance Aircraft Servs.*, 82 S.W.3d 691, 695 (Tex. App.—Eastland 2002, no pet.).

<sup>100</sup> See *Trans-Gulf*, 82 S.W.3d at 696.

<sup>101</sup> See *Coastal Conduit & Ditching Inc. v. Noram Energy Corp.*, 29 S.W.3d 282, 286 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

<sup>102</sup> See *Coastal Conduit*, 29 S.W.3d at 289.

negligence.<sup>103</sup> Although the plaintiff appeared to have argued that its negligent misrepresentation claim was not barred by the economic loss rule, the court refused to address the issue as the plaintiff had not appealed the granting of summary judgment on its negligent misrepresentation claim.<sup>104</sup>

In *Hou-Tex Inc. v. Landmark Graphics*, the Houston Court of Appeals ruled that allowing the plaintiff, who was not in privity with the defendant, to maintain a suit for economic losses would disrupt the contractual risk allocations between the various parties.<sup>105</sup> Thus, the economic loss rule barred the plaintiff from recovering economic damages.<sup>106</sup> As discussed above, this rationale can be particularly unfair when some risks cannot be addressed contractually. It is important to note that the court did not discuss the applicability of the economic loss rule to negligent misrepresentation claims.

In *Sterling Chems. Inc. v. Texaco Inc.*, the Houston Court of Appeals incorrectly ruled that negligent misrepresentation does not operate as an exception to the economic loss doctrine, even where the parties are not in privity.<sup>107</sup> With this case, the Houston Court of Appeals has gone too far in applying the economic loss rule. It has been applied in a manner that destroys valid claims that numerous other courts, including the Texas Supreme Court, have recognized. The better rule is to allow the recovery of economic damages in a claim for negligent misrepresentation when the parties are not in privity. It is already a *de facto* exception to the economic loss rule, which has been recognized by

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<sup>103</sup> See *Coastal Conduit*, 29 S.W.3d at 287-88.

<sup>104</sup> See *Coastal Conduit*, 29 S.W.3d at 289 n.2.

<sup>105</sup> See *Hou-Tex Inc. v. Landmark Graphics*, 26 S.W.3d 103, 107 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

<sup>106</sup> See *Hou-Tex*, 26 S.W.3d at 107.

<sup>107</sup> See *Sterling Chems., Inc. v. Texaco Inc.*, 259 S.W.3d 793, 799 (Tex. App.—Houston [1st Dist.] 2007, pet. denied).

the Texas Supreme Court and numerous Texas appellate courts.

**C. Conclusion**

Allowing the economic loss rule to bar negligent misrepresentation claims where parties are not in privity of contract is contradictory to the sections of the Restatement (Second) of Torts that have been expressly adopted by the Texas Supreme Court and repeatedly addressed by Texas appellate courts. The economic loss rule simply does not apply to negligent misrepresentation claims where parties are not in privity of contract.

**PRAYER**

For these reasons, the undersigned requests that this Court reverse the judgment of the Appellate Court and affirm the judgment of the Trial Court as to the negligence claims.

Respectfully submitted,

**FORD NASSEN & BALDWIN P.C.**

111 Congress Ave., Suite 1010

Austin, Texas 78701

512.236.0009 (telephone)

512.236.0682 (facsimile)

By: \_\_\_\_\_

R. Carson Fisk

State Bar No. 24043659

**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing has been served pursuant to the Texas Rules of Appellate Procedure via certified mail, return receipt requested, to the following person(s) on December \_\_\_\_\_, 2009.

**Sharyland Water Supply Corporation**

J. W. Dyer  
Sharon Almaguer  
DYER & ASSOCIATES  
1352 W. Pecan Blvd.  
McAllen, Texas 78501-4351

**City of Alton, Texas**

Eileen Marie Leeds  
WILLETTE & GUERRA L.L.P.  
1534 E. 6th St., Suite 200  
Brownsville, Texas 78520

**Carter & Burgess Inc.**

Stephen L. Tatum  
Tolbert L. Greenwood  
Stephanie Kay Smith  
Andrew Derald Keetch  
CANTEY HANGER L.L.P.  
600 W. 6th St., Suite 300  
Fort Worth, Texas 76102-3685

Jeffrey D. Roerig  
Rene O. Oliveira  
ROERIG OLIVEIRA & FISHER L.L.P.  
855 W. Price Rd., Suite 9  
Brownsville, Texas 78520

**Turner Collie & Branden Inc.**

John B. Wallace  
BARKER LYMAN P.C.  
1221 McKinney St.  
3600 One Houston Center  
Houston, Texas 77010-2011

Marcus Montalvo  
MONTALVO LAW  
900 N. Main  
McAllen, Texas 78501

**Cris Equipment Company Inc.**

Christopher Allen Funk  
WALKER & TWENHAFEL L.L.P.  
Frost National Bank Building  
2424 N. 10th St., Suite 200  
McAllen, Texas 78502

By: \_\_\_\_\_  
R. Carson Fisk

## **Appendix**

- Text of Restatement of the Law, Second, Torts, § 324
- Text of Restatement of the Law, Second, Torts, § 552
- Text of Restatement of the Law, Second, Torts, § 552B

## **Restatement of the Law, Second, Torts, § 324**

### § 324A Liability to Third Person for Negligent Performance of Undertaking

One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to protect his undertaking, if

- (a) his failure to exercise reasonable care increases the risk of such harm, or
- (b) he has undertaken to perform a duty owed by the other to the third person, or
- (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.

CAVEAT: Caveat:

The Institute expresses no opinion as to whether:

- (1) the making of a contract or a gratuitous promise, without in any way entering upon performance, is a sufficient undertaking to result in liability under the rule stated in this Section, or
- (2) there may not be other situations in which one who has entered upon performance may be liable to a third person, where he is committed to the undertaking and cannot withdraw from it without leaving an unreasonable risk of harm to the third person.

## **Restatement of the Law, Second, Torts, § 552**

### § 552 Information Negligently Supplied for the Guidance of Others

- (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
- (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
  - (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
  - (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.
- (3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

## **Restatement of the Law, Second, Torts, § 552B**

### § 552B Damages for Negligent Misrepresentation

- (1) The damages recoverable for a negligent misrepresentation are those necessary to compensate the plaintiff for the pecuniary loss to him of which the misrepresentation is a legal cause, including
  - (a) the difference between the value of what he has received in the transaction and its purchase price or other value given for it; and
  - (b) pecuniary loss suffered otherwise as a consequence of the plaintiff's reliance upon the misrepresentation.
- (2) the damages recoverable for a negligent misrepresentation do not include the benefit of the plaintiff's contract with the defendant.