No. 11-0810

IN THE SUPREME COURT OF TEXAS

LAN/STV, A Joint Venture of LOCKWOOD, ANDREWS & NEWMAN, INC. and STV INCORPORATED,

Petitioners,

v.

MARTIN K. EBY CONSTRUCTION COMPANY, INC.,

Respondent.

On Petition for Review from the
Court of Appeals For The Fifth District of Texas

LAN/STV'S REPLY IN SUPPORT OF ITS PETITION FOR REVIEW

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PRELIMINARY STATEMENT

A recent opinion from the Fourteenth Court of Appeals—*Barzoukas v. Foundation Design, Ltd.*—confirms the importance and merits of LAN/STV's petition for review.

Barzoukas, issued on March 1, 2012, involves a claim for negligent misrepresentation against a third-party design professional on a construction project. The court of appeals examined the economic loss rule and held that the case involved the question "left open" in *Sharyland Water Supply Corp. v. City of Alton*. However, the court ultimately did not reach the question because the contracts were not in evidence to prove a "contractual chain" and "allocation of risk" among the parties.

Nevertheless, the opinion demonstrates the prevalence of negligent misrepresentation claims among contracting parties in a construction context. The opinion also confirms LAN/STV's reading of *Sharyland* and illustrates why this case presents a good vehicle to address the unexplored question in that case: the parties here were in a contractual chain and the contracts are in evidence to prove it.

In short, contrary to Eby's repeated assertions that the law is well established, the issues involved in this petition are not resolved, but are important and ripe for review.

ARGUMENT

I. This case involves important issues raised but not reached in *Sharyland.*

This petition presents the Court with the opportunity to continue its analysis of the economic loss rule started—but not finished—in *Sharyland Water Supply Corp. v. City of Alton*. 354 S.W.3d 407 (Tex. 2011).[1] There, the Court explained that it has previously

1 The economic loss rule bars recovery of purely economic losses in selected areas of tort law. *Id.* at 415.

applied the economic loss rule "only in cases involving defective products or failure to perform a contract," but it has "never held that [the rule] precludes recovery completely between contractual strangers in a case not involving a defective product." *Id.* at 418. That situation "involves a third formulation of the economic loss rule." *Id.* at 419. However, the Court did not reach the issue because the case involved property damage, not purely economic loss. Thus, *Sharyland* left open the question of how the economic loss rule applies to tort claims between contractual strangers in a non-product-defect case.

In response, Eby accuses LAN/STV of "mischaracterizing" *Sharyland*. (Resp. at 5.) It claims that the third formulation involves only "negligence or strict liability cases" and does not include a claim for "negligent misrepresentation." (Resp. at 6.) According to Eby, "the economic loss rule simply does not apply to the tort of negligent misrepresentation." (Resp. at 4.) That is not the answer; it is the question. Despite Eby's contentions, *Sharyland* does not "close" the door to further review of this case.[2] If a negligent misrepresentation claim between parties in a contractual chain avoids the economic loss rule, contract law, again, will drown in a sea of torts.

A. *Sharyland* left open the question of how the economic loss rule applies between contractual strangers when there is no product defect.

As mentioned above, the Fourteenth Court of Appeals recently issued an opinion confirming LAN/STV's reading of *Sharyland*. In *Barzoukas v. Foundation Design, Ltd.*,

2 Eby also alleges—without citation to any authority—that LAN/STV "abandoned" the economic loss rule argument by not asserting it in the prior appeal of a summary judgment. However, this is an appeal from a final judgment and LAN/STV raised the argument at every stage of the trial proceedings, including in its First Amended Answer and Special Exceptions (CR 40), Motion for Summary Judgment (CR 99, 119–28), Motion for Directed Verdict (7 RR 101–02), and Motion to Disregard Certain Jury Findings and Motion to Modify, Correct, or Reform the Judgment. (CR 294, 301–04.)

a homeowner sued a third-party design company and its engineer of record for negligence and negligent misrepresentation in the construction of his home. No. 14-10-00505-CV, 2012 Tex. App. LEXIS 1619, at *3 (Tex. App.—Houston [14th Dist.] Mar. 1, 2012, no pet. h.). The trial court granted summary judgment. *Id.* On appeal, the "primary issue was whether the homeowner's "negligence and negligent misrepresentation claims are foreclosed under the economic loss rule." *Id.* at *4.

In its opinion, the court of appeals examined the economic loss rule in Texas and noted that its "boundaries are not entirely settled" and that "areas of uncertainty exist." *Id.* at *5, 8. The court then explained that *Sharyland* gives only "partial guidance" and "left open" the very question involved in the case:

> [W]e must address a different question that was left open in *Sharyland* by addressing whether—in the particular home construction circumstances presented here—the economic loss rule "precludes recovery completely *between contractual strangers in a case not involving a defective product* . . . ."

Id. at *17 (emphasis added). In other words, the Fourteenth Court of Appeals recognized, as LAN/STV argues here, that *Sharyland* left open the question of how the economic loss rule applies to a negligent misrepresentation claim (like Eby's) against a third-party design professional (like LAN/STV).

B. Unlike fraudulent inducement, negligent misrepresentation is not a blanket exception to the economic loss rule in Texas.

Eby contends, or at least implies, that negligent misrepresentation is a blanket exception to the economic loss rule.[3] Although that is true in some states,[4] it is not in

3 Eby relies on footnote 24 of *Sharyland*, which cites to a law review article "noting exceptions to economic loss rule including negligent misrepresentation." (Resp. at 6.) However, the point of the note is that the economic

Texas. In this state, fraudulent inducement is the *only* exception to the economic loss rule. *See Sharyland*, 354 S.W.3d at 417–18 n.2; *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 663 (Tex. 1998). Indeed, post-*Sharyland* decisions have continued to apply the economic loss rule to negligent misrepresentation claims. *See, e.g.*, *Hurd v. BAC Home Loans Servicing, LP*, No. 3:11-CV-1752-M, 2012 U.S. Dist. LEXIS 44937, at *30 (N.D. Tex. Mar. 12, 2012) ("The [economic loss] rule is applicable to a claim for negligent misrepresentation in Texas."); *Barzoukas*, 2012 Tex. App. LEXIS 1619, at *17.[5]

C. Negligent misrepresentation cases addressing the measure of damages or claims against other professionals also do not preclude review.

In its response, Eby contends that two "longstanding" principles with "two decades of Texas precedent" also preclude further review of this case. (Resp. at vi, viii, 4–8.) First, Eby claims that *Sharyland* confirms the "measure of damages for negligent misrepresentation claims." (Resp. at 7.) However, the applicable measure of damages is not in dispute.[6] What is in dispute, and what *Sharyland* leaves open, is whether the economic loss rule bars a negligent misrepresentation claim for purely economic losses between parties in a contractual chain on a construction project.

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loss rule does not *always* bar purely economic losses in tort. That is different than saying the rule *never* applies to a claim for negligent misrepresentation. Regardless, this is another reason why this case warrants review.

4 Some states hold—as Eby urges—that negligent misrepresentation, like fraudulent inducement, is a blanket exception to the economic loss rule. However, Texas is not one of those states. Texas has also not adopted—like the out-of-state cases cited by LAN/STV—illustration 9 to section 552 of the Restatement. (Pet. at 13–14.)

5 The dissent in *Barzoukas* does not dispute whether the economic loss rule applies to negligent misrepresentation. In fact, Justice Seymore dissented because he believed that the economic loss rule barred the claim even without the contracts in evidence.

6 There is a dispute as to whether Eby *sought* the proper damages. Eby's damage model plainly includes profits, which are not out-of-pocket expenses. (8 RR Pl.'s Ex. 639.)

Second, Eby asserts that Texas recognizes negligent misrepresentation claims against professionals and no "special exemption" should apply to design professionals. (Resp. at 7.) However, the economic loss rule requires a court to look, not at a class of defendants such as "professionals," but at whether the plaintiff's losses are independent from the economic losses recoverable under a breach of contract claim. *See Sharyland*, 354 S.W.3d at 417–18; *D.S.A.*, 973 S.W.2d at 664. To evaluate such a claim, courts examine both (1) the source of the duty allegedly breached by the defendant and (2) the nature of the plaintiff's loss. *Sw. Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 494 (Tex. 1991). This Court should determine whether the *DeLanney* analysis applies in this case, or whether a party like Eby—who could (and did) recover similar damages from a party with whom it is in privity—can reach up the contractual chain in tort.

While some third parties—i.e., those who have no contractual remedy—might need a remedy in negligent misrepresentation, *e.g.*, *Grant Thornton LLP v. Prospect High Income Fund*, 314 S.W.3d 913, 918–19 (Tex. 2010) (negligent misrepresentation claim by investors against accountants), parties in the construction business do not. Their obligations and rights are defined by multiple contracts, and they ought to look to those rights rather than inventive tort remedies.

II. This case—involving third parties in a contractual chain on a complex construction project—presents a good vehicle for the Court to answer the question left open in *Sharyland*.

The nature of the construction industry makes the application of the economic loss rule very important, especially on large construction projects with many parties and many interlocking sets of voluminous contracts. As courts have explained, these detailed and

comprehensive contracts "form the foundation of the industry's operations." *Am. Towers Owners Ass'n Inc. v. CCI Mech., Inc.*, 930 P.2d 1182, 1190 (Utah 1996). This industry is where "we see most clearly the importance of the precise allocation of risk as secured by contract." *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, 881 P.2d 986, 992 (Wash. 1994). On the NW-1A construction project here, every participant—contractor, subcontractor, and design professional—had a contract with someone, with each contract providing various remedies for economic losses.[7]

In its response, Eby complains that LAN/STV "focuses myopically" on the risk allocations in construction contracts. (Resp. at 9.) However, in *Sharyland*, this Court expressly distinguished the case from the usual construction defect case "involv[ing] parties in a contractual chain who have had the opportunity to allocate risk." 354 S.W.3d at 420. The Court held that "[t]he rule cannot apply to parties without even remote contractual privity." *Id.* Likewise, in *Barzoukas*, the court of appeals explained why "details matter" in cases like this:

> Although areas of uncertainty exist under case law addressing the economic loss rule in Texas, at least one thing is clear: Details matter.
>
> It matters who contracted with whom to do what. It matters what the contracts say; what they cover; and what they do not cover. It matters what kind of damages are requested. It matters whether the requested damages are attributed to activities covered by the contracts. It matters whether and how multiple parties in a chain of contracts allocated among themselves the risk that participants in the chain would perform deficiently, along with the obligation to pay for deficient performance. It matters what kinds of claims are asserted and against whom they are asserted.

7 Eby claims that the contracts involved here "have no effect" on Eby's negligent misrepresentation claim. (Resp. at 9.) Eby misses the point. The contracts allocated risk among the parties for economic losses.

2012 Tex. App. LEXIS 1619, at *8–9. Myopic or not, a detailed analysis is critical to the construction industry.

Moreover, this case presents the Court with a good vehicle to continue its analysis of the economic loss rule. Unlike in *Sharyland*, Eby's damages are for purely economic loss. Unlike in *Barzoukas*, the contracts here are in the record and show that Eby and LAN/STV were in a contractual chain and expressly allocated risk. (Pet. at 9–10) (8 RR Def.'s Exs. 2005, 2054.) In short, there are no hindrances to prevent the Court from addressing the question left open in *Sharyland*.

III. Eby's tort claim is barred by derivative sovereign immunity.

This case also presents another important issue—derivative sovereign immunity—in the context of two statutes that this Court has not yet construed. Both statutes provide that an independent contractor working for a transportation agency is liable "only to the extent that the authority would be liable if it were performing the function." TEX. TRANSP. CODE § 452.056(d); TEX. REV. CIV. STAT. ANN. art. 6550d. Eby does not dispute the importance or novelty of these statutes. Instead, it contends that derivative sovereign immunity does not apply because, essentially, Eby had a contract claim against DART.[8] (Resp. at 13–15.)

This is not the first time a contractor has made this argument against LAN/STV on a DART project. In *GLF Construction Corp. v. LAN/STV*, a contractor (GLF)—hired by

8 Eby also argues that the prior appeal is law of the case, citing to *Briscoe v. Goodmark Corp.*, 102 S.W.3d 714 (Tex. 2003). However, this Court is not bound by a prior court of appeals' decision issued on review of a summary judgment. *Briscoe* does not suggest otherwise. Instead, *Briscoe* examines whether a *court of appeals* is ordinarily bound by its prior decision. *Id.* at 716. Even then, the Court said that a prior decision "does not absolutely bar re-consideration of the same issue on a second appeal" and especially when "the appellate court's original decision is clearly erroneous." *Id.*

DART to build a different extension to the light rail system—sued LAN/STV for negligence and "misrepresentation." 414 F.3d 553, 555 (5th Cir. 2005). GLF argued (like Eby here) that, "because it would have a cause of action against DART for breach of contract, Article 6550d does not prohibit it from suing LAN/STV in tort." *Id.* at 557. The Fifth Circuit rejected this contention:

> We disagree. Texas law carves out certain exceptions to the general rule that DART, as a government entity, is immune from suit and liability. Through the Texas Tort Claims Act, it permits liability for certain tort claims. It permits liability for breach of contract through administrative remedies and, where the plaintiffs have exhausted those remedies, through suits for breach of contract. It also limits the maximum amount of liability for certain areas in which it has waived immunity from liability and suit. Texas law thus limits DART's liability both in terms of the causes of action for which DART may be held liable and, for some claims, the maximum amount of recovery. Article 6550(d) effectively places LAN/STV, as an independent contractor performing DART's functions, in DART's shoes for purposes of liability. That is, as the language of the statute plainly states, LAN/STV is liable "only to the extent" that the DART itself would be liable had it performed the same function. Texas law would not permit DART to be held liable in tort on these facts. Accordingly, neither does Article 6550d permit LAN/STV, performing DART's functions, to be held liable in tort.
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> . . . .
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> . . . It does not follow, however, that by using the word "liable" in Article 6550d, the legislature intended to permit independent contractors to be held liable under any cause of action so long as the government entity for whom the contractor was acting could be liable for breach of contract.

Id. (citations omitted). Likewise here, because DART would not be liable in tort, neither should Eby. This Court should grant review to address this important issue.

CONCLUSION

For the foregoing reasons, LAN/STV requests that this Court grant its petition for review, reverse the court of appeals' judgment, and render judgment in favor of LAN/STV.

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CERTIFICATE OF SERVICE

I certify that a true and correct copy of the above and foregoing has been forwarded via electronic service or email to the counsel named below on this 25th day of May, 2012.

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