SHARYLAND WATER V. CITY OF ALTON: REIGNING IN THE ECONOMIC LOSS RULE?

7TH ANNUAL CONSTRUCTION SYMPOSIUM

Prepared by:

Wesley G. Johnson
Timothy Micah Dortch

Cooper & Scully
A Professional Corporation

900 Jackson Street, Suite 100
Dallas, TX 75202
Telephone: 214-712-9500
Telecopy: 214-712-9540

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SHARYLAND WATER V. CITY OF ALTON: REIGNING IN THE ECONOMIC LOSS RULE?

I. INTRODUCTION:

The economic loss rule is a judicially created doctrine that sets forth the circumstances under which a tort action is prohibited if the only damages suffered are economic losses. In Texas, the economic loss rule has been applied to preclude tort claims in two related contexts: (1) where the losses sought to be recovered are the subject matter of a contract between the parties; and (2) when the claims are for economic losses against the manufacturer or seller of a defective product where the defect damaged only the product and did not cause personal injury or damage to other property. *Wolf Hollow I, L.P. v. El Paso Mktg, L.P.,* --- S.W.3d ----, 2010 WL 4262048, at *5 (Tex.App. – Houston [14th. Dist.] Jan. 11, 2011); *Coastal Conduit & Ditching,* 29 S.W.3d 282, 285 (Tex.App.-Houston [14th Dist.] 2000, no pet.). Once the other parameters are established, the rule bars recovery even if the parties are not in contractual privity. *City of Alton v. Sharyland Water Supply Corp.,* 277 S.W.3d 132, 152 (Tex.App.-Corpus Christi 2009, pet. filed) (op. on rehr'g) (quoting *Sterling Chems., Inc. v. Texaco Inc.,* 259 S.W.3d 793, 797 (Tex.App.-Houston [1st Dist.] 2007, pet. denied)). Plaintiffs routinely recover economic damages, such as lost wages, hospital bills, etc., in negligence and strict products liability actions when they *also* suffer personal injury or property damage.

The rule itself has created a tremendous amount of controversy as many parties believe that it is being applying far more broadly than intended. A great deal of confusion exists amongst litigants and courts about when to apply the economic loss rule and what are the limits of its preclusive reach. This paper discusses the nature of the economic loss rule as it exists in Texas and specifically discusses the challenges/opportunities that it presents in the context of construction litigation.

II. THE ECONOMIC LOSS RULE GENERALLY

Nationally, most jurisdictions follow the rule and see two distinct settings wherein the rule should be applied to preclude tort liability. The seminal case of *Indemnity Ins. Co. v. American Aviation, Inc.,* 891 So.2d 532 (Fla.2004) provides the best and most in-depth discussion of this majority view. The first application is when the parties are in contractual privity and one party seeks to recover damages in tort for matters arising from the contract. The second is when there is a defect in a product that causes damage to the product but causes no personal injury or damage to other property. *Id.* at 536.

A. The *American Aviation* Decision

The first application of the *American Aviation* interpretation of the rule regards the general prohibition against tort actions to recover solely economic damages for those in contractual privity. The case stated that this rule is designed to prevent parties to a contract from circumventing the allocation of losses set forth in the contract by bringing an action for economic loss in tort. *American Aviation, Inc.,* 891 So.2d at 536. Citing *Ginsberg v. Lennar Fla. Holdings, Inc.,* 645 So.2d 490, 494 (Fla. 3d DCA 1994) ("Where damages sought in tort are the same as those for breach of contract a plaintiff may not circumvent the contractual relationship by bringing an action in tort."). The Florida court continued by holding that underlying this rule is the assumption that the parties to a contract have allocated the economic risks of nonperformance through the bargaining process. A party to a contract who attempts to circumvent the contractual agreement by making a claim for economic loss in tort is, in effect, seeking to obtain a better bargain than originally made. *Id.* Thus, when the parties are in privity, contract principles are generally more appropriate for determining remedies for consequential damages that the parties have, or could have, addressed through their contractual agreement. *Id.* at 536-37. Accordingly, courts have held that a tort action is barred where a defendant has not committed a breach of duty apart from a breach of contract. *See, e.g., Electronic Sec. Sys. Corp. v. Southern Bell Tel.*

& Tel. Co., 482 So.2d 518, 519 (Fla. 3d DCA 1986) (stating that "breach of contract, alone, cannot constitute a cause of action in tort ... [and][i]t is only when the breach of contract is attended by some additional conduct which amounts to an independent tort that such breach can constitute negligence"); *Weimar v. Yacht Club Point Estates, Inc.,* 223 So.2d 100, 103 (Fla. 4th DCA 1969) ("[N]o cause of action in tort can arise from a breach of a duty existing by virtue of contract.").

American *Aviation* is the most discussed case in the context of the economic loss rule because it provides a great depth of analysis and discussion on the topic – far more in depth than any other case from any jurisdiction. However, the gravamen of the decision was its conclusion that absent contractual privity, the only intended application for the economic loss rule lie the context of products liability. *American Aviation* expressly reversed decades of Florida law that saw ever expanding applications of the economic loss rule beyond its products liability roots into areas such as negligent entrustment, strict liability, construction defect litigation, etc. The Court noted this trend at length and rejected previous holdings stating:

"This case does not involve a cause of action against a manufacturer or distributor for economic loss caused by a product which damages itself. Thus, the products liability economic loss rule is inapplicable. Nor does this case involve parties who enjoy privity of contract. Thus, the economic loss rule for those in privity of contract is inapplicable. Rather, this case involves plaintiffs who claim economic loss caused by the alleged negligence of a defendant with whom the plaintiffs were not in privity." *American Aviation, Inc.,* 891 So.2d at 541.

In reaching this holding, the Florida Supreme Court began a trend of reversing the ever expanding vista of the economic loss rule from its application to virtually type of case that involved "pure economic loss" to solely the areas where contractual privity exists or in the limited application of products liability cases. *American Aviation* touched off legal debate in many jurisdictions about the potential overreach of the doctrine. Texas has not been immune. However, as demonstrated below, as the nation seems to be trending towards the limitations described in *American Aviation*, Texas courts have followed their own path – until *Sharyland*.

III. DEVELOPMENT OF THE ECONOMIC LOSS RULE IN TEXAS

Texas jurisprudence has always been somewhat awkward with respect to applying the economic loss rule. This is likely because historically, three different lines of cases formed that different courts applied depending on the case. The earliest of these cases, applied a restrictive view of the doctrine, with each change seeming to expand its horizons.

A. *Montgomery Ward & Co. v. Scharrenbeck*:

The first Texas case to truly analyze the economic loss rule in Texas is the 1947 Texas Supreme Court case, *Montgomery Ward & Co. v. Scharrenbeck,* 146 Tex. 153, 204 S.W.2d 508 (1947).

In *Scharrenbeck,* the defendant agreed to repair a water heater in plaintiff's home. A short time after repair, the heater ignited the roof, destroying the house and its contents. Although the contract obligated the defendant to put the water heater back in good working order, the law also implied a duty to the defendant to act with reasonable skill and diligence in making the repairs so as not to injure a person or property by his performance. In failing to repair the water heater properly, the defendant breached its contract. In burning down plaintiff's home, the defendant breached a common-law duty as well, thereby providing a basis for plaintiff's recovery in tort. *Id.* at 510.

The Court held that accompanying every contract is a common-law duty to perform with care, skill, reasonable expedience and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of the contract. The key test in *Scharrenbeck* is whether the negligent act complained of – absent

the presence of a contract – would give rise to tort liability independently. See *Southwestern Bell Tel. Co. v. DeLanney,* 809 S.W.2d 493, 494-95 (Tex.1991).

Scharrenbeck somewhat neutered the economic loss rule outside of its products liability context because in many, if not most, occasions of claimed liability for negligence, the alleged negligent activity would generally give rise to tort liability even if the parties did not hold a contract. For instance, in the construction litigation context, construction defect claims for negligent construction by a contractor can clearly be brought in tort as the implied warranties and duties of construction in a good and workmanlike manner give rise to tort liability regardless of the contract between the parties. Consequently, *Scharrenbeck* put a chill to any potential application of the economic loss doctrine in a construction context.

B. The *Testbank* Decision:

As mentioned above, the "economic loss" rule precludes recovery only when the plaintiff suffers nothing other than economic loss. This is referred to in case law as "pure economic loss" and it historically was applied in products liability cases or in cases where the parties in interest were in contractual privity. However, the doctrine seemed to expand a great deal with the 1985 Fifth Circuit decision in *Louisiana ex. rel. Guste v. M/V Testbank,* 752 F.2d 1019 (5th Cir. 1985), *cert. denied,* 477 U.S. 903 (1986). In *Testbank*, the Fifth Circuit held that the "economic loss" rule precluded businesses along the Mississippi River from recovering lost profits when a spill from the defendant's ship blocked traffic on a portion of the River. The plaintiffs did not suffer property damage or personal injury. However, if the plaintiff's property had been damaged by the spill, they could have recovered lost profits caused by the damage to their property.

The most important fact of the *Testbank* decision is the fact that none of the parties were in contractual privity with one another. The Fifth Circuit had applied the "pure economic loss" rule that was born of products liability towards that case involving the secondary economic losses suffered from a chemical spill in the Mississippi River by businesses who were affected by the cessation of river traffic during cleanup. The *Testbank* decision was not a decision involving Texas law. However, this is the clear moment where Texas jurisprudence takes a dramatic turn in the application of the economic loss doctrine, which was for the most part was confined to products liability actions to this point and was about to become a central player in construction defect litigation.

C. *Jim Walter Homes v. Reed*:

It is likely not coincidental that less than a year after the *Testbank* decision, the seminal Texas Supreme Court case on the economic loss rule was rendered. The 1986 *Reed* decision is the case where the marriage of the economic loss rule and construction litigation occurs. In *Jim Walter Homes,* Ray Reed and his wife sued Jim Walter Homes, Inc., seeking damages arising out of the sale and construction of a house. The jury found that Jim Walter Homes, Inc. breached the warranty of good workmanship in the contract and that it was grossly negligent in the supervision of the construction of the house. Id. at 615.

Reed analyzed the impact of *Scharrenbeck* and applied it to the Reed's claims. In *Reed*, the plaintiffs were dissatisfied with the quality of a house they had contracted to buy from the builder and sued for actual and exemplary damages, alleging breach of warranty (contract theory) as well as negligent supervision of construction (tort theory). *Id.* In reversing an award of exemplary damages to the plaintiffs, the Texas Supreme Court held that if the injury is only the economic loss of the bargained-for subject of a contract, the action is in contract alone. Because the only harm shown to have befallen the plaintiffs was that the house they were promised was not the house they received, the only cause of action available was one characterized as a breach of contract, which does not support recovery of exemplary damages. The Court concluded by observing that to support the award of exemplary damages, the plaintiffs were obliged to prove a "distinct tortious injury with actual damages." *Id.* at 618.

This analysis relied on *Scharrenbeck* in stating that the nature of the injury most often determines which duty or duties are breached. *Reed* states that "when the injury is only the economic loss to the subject of a contract itself, the action sounds in contract alone." *Id.* at 618. Citing *Mid-Continent Aircraft Corp. v. Curry County Spraying Service,* 572 S.W.2d 308, 312 (Tex.1978); *Nobility Homes of Texas, Inc. v. Shivers,* 557 S.W.2d 77 (Tex.1977). The Court continued by stating that "The Reeds' injury was that the house they were promised and paid for was not the house they received. This can only be characterized as a breach of contract, and breach of contract cannot support recovery of exemplary damages." *Id.* Citing *Bellefonte Underwriters Insurance Co. v. Brown,* 704 S.W.2d 742 (1986); *Amoco Production Co. v. Alexander,* 622 S.W.2d 563 (Tex.1981).

While this language seems to work and follow *Scharrenbeck* and its line of cases, the reality is that it is different and that difference seems to open a Pandora's Box. *Scharrenbeck* looks at the alleged negligent act and attempts to determine if that act absent a contract would give rise to tort liability. *Reed* seems to apply more of a "but for" test. Unless there was a contractual relationship, would there be any liability? This subtle distinction would seem to be the trigger to the modern day use of contractors, particularly subcontractors, invoking the economic loss doctrine in construction defect litigation. Particularly subcontractors benefit from this application because the home or structure that was bargained for is always the product of a contract.

Note how different the rule from *Reed* is than the majority rule referenced in American Aviation. The *Reed* rule precludes tort claims brought to recover economic losses when those losses are the subject matter of a contract. It never specifically states that all of the parties seeking to apply the doctrine must be in privity with the plaintiff such as *American Aviation*. *Reed* does not expressly go so far as removing the requirement of contractual privity and truly unleashing the rule (the problem noted in *American Aviation*).

D. The 2000s: The ELR Becomes a Shield

The *Reed* rule attempted to apply *Scharrenbeck* while making a subtle change that drew more inference on the presence of the contract itself as the preclusive event. However, the parties in *Reed* were in privity of contract and Reed did not expressly rely upon *Testbank* (although the recent interest generated by that decision in the economic loss rule in negligence cases likely played some role in the expansion of the doctrine.). However, in the early 2000s, the *Reed* and *Testbank* interpretations were morphed together by various decisions of the intermediate Texas Courts of Appeals.

These cases held that the economic loss doctrine does not apply only to bar claims against those in a direct contractual relationship; it also applies to preclude tort claims between parties who are not in privity, provided that the ultimate source of the loss involved a contract upon the plaintiff can seek recovery. *Trans-Gulf Corp. v. Perf. Aircraft Servs., Inc.,* 82 S.W.3d 691, 695 (Tex.App.-Eastland 2002, no pet.) and *Hou-Tex, Inc. v. Landmark Graphics,* 26 S.W.3d 103, 106-07 (Tex.App.-Houston [14th Dist.] 2000, no pet.)). Consequently, the lack of contractual privity was no bar to someone from invoking the economic loss rule provided that the plaintiff had a contractual action against someone (and the injuries involved were only economic in nature).

During the early 2000s, subcontractors began to rely heavily on the economic loss doctrine to avoid liability. This mechanism was simple. In construction defect claims, the injuries involved are generally always economic only. Thus, the plaintiffs are restricted to their breach of contract claims. However, most subcontractors have no direct contract with the plaintiff – only the general contractor. Thus, plaintiff's sole action under a contract theory would just be against the general contractor. Moreover, as contribution claims are derivative of tort actions, the general contractor could not merely bring the subcontractors back in under a theory of contribution. Thus, the economic loss doctrine essentially allowed subcontractors to evade liability for their defects and leave the

general contractor holding the bag, absent a contractual indemnity provision in the subcontract.

IV. SHARYLAND WATER V. CITY OF ALTON

Beginning with the widely discussed opinion in *American Aviation* in 2004, many began to believe that Texas courts, in particular the Texas Supreme Court, would begin to reconsider the vast scope of the modern interpretation of the economic loss rule in the same manner that the Florida Supreme Court did in *American Aviation*.

A. Lamar Homes v. Mid-Continent:

In fact, there was a major indication of that from the Texas Supreme Court when in the 2007 case *Lamar Homes, Inc. v. Mid-Continent Cas. Co.,* 242 S.W.3d 1, 12 (Tex.2007) the Court declined to apply the economic loss rule to the context a first-party insurance claim regarding alleged construction defects. While *Lamar Homes* was an insurance law decision, this was the first the Supreme Court had said in depth about the rule since 1991 and certainly after the American Aviation decision. It certainly appeared that the Court could be amenable to adopting an more restrictive interpretation than the Court of Appeal decision and perhaps more along the lines of *American Aviation* with respect to contractual privity.

B. Facts of the *Sharyland* Dispute:

In the *Sharyland* cases, the City of Alton contracted Sharyland to sell and deliver water and/or sewer service to Alton. In order to provide sewage disposal for more of its residents, Alton entered into various other contracts with Carter & Burgess Civil Engineers (C&B), Turner, Collie & Braden (TCB) and Cris Equipment Company (Cris) to design, manage, inspect and install the sanitary sewer system to these residents. *Id.* Sharyland brought suit against Alton, C&B, TCB and Cris for negligence, claiming that the sewer connections were installed in violation of state regulations and industry standards, and represented a threat to Sharyland's potable water system. *Id.* at 140. On appeal, the engineering defendants C&B, TCB and Cris (collectively "the engineering defendants") claimed that the economic loss doctrine barred Sharyland's negligence cause of action because Sharyland claimed economic damages, yet failed to claim and prove damage to other property. *Id.* at 152-53.

C. Corpus Christi Court of Appeals Decides *City of Alton v. Sharyland Water Supply Corp:*

In *City of Alton v. Sharyland Water Supply Corp.,* 277 S.W.3d 132, 152 (Tex.App.-Corpus Christi 2009, pet. filed) the Fourteenth Court of Appeals did not take notice of the Texas Supreme Court's apparent desire to relax the application of the ELR.. In *Sharyland,* the court held that 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. *Sharyland*, 277 S.W.3d at 152-53. Citing *Express One Int'l, Inc. v. Steinbeck,* 53 S.W.3d 895, 899 (Tex.App.-Dallas 2001, no pet.); *Coastal Conduit & Ditching, Inc. v. Noram Energy Corp.,* 29 S.W.3d 282, 288-89 (Tex.App.-Houston [14th Dist.] 2000, no pet.); *Hou-Tex, Inc. v. Landmark Graphics,* 26 S.W.3d 103, 107 (Tex.App.-Houston [14th Dist.] 2000, no pet.). The key question was whether *Sharyland* suffered property damage, such that the economic loss rule will not bar its recovery.

The Court examined a great deal of case law in determining the definition of "property damage" to be used in the opinion. The court concluded:

> "that property damage cannot consist merely of damage to an intangible asset or increased operational costs. Instead, some physical destruction of tangible property must occur. Based on this determination, we conclude that Sharyland has not suffered property damage. The sewer service lines have not corroded the waterlines. There is no evidence of physical damage to the waterlines, nor is there evidence that the water flowing through the water mains has been contaminated because of sewage leaks. Thus, Sharyland neither pleaded nor offered evidence of an actual injury or property

damage to its waterlines or to the water that flows through the waterlines. Sharyland seeks compensation only for economic damages including the cost associated with protecting, maintaining, and repairing its waterlines. Because Sharyland has not identified any property damage that it has sustained as a result of the sewer line being laid above its waterlines, we conclude that the economic loss rule bars Sharyland's negligence claim against C & B, TCB, and Cris, parties with which it is not in contractual privity." *Id.* at 154-55.

Thus, the rule used by *Sharyland* is that to avoid the economic loss rule, some physical destruction must occur. At first glance this would seem to relax the rule as it appears that any claim of physical destruction would avoid the doctrine. However, the Court followed the decision in the *Thomson* case for defining "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....' " *Thomson v. Espey Huston & Assocs.,* 899 S.W.2d 415, 421 (Tex.App.-Austin 1995, no writ). Thus, the Court of Appeals decision literally took the ELR "shield" out as far as it ever had been before.

D. The Supreme Court Decision on the Scope of the Economic Loss Rule:

On appeal to the Texas Supreme Court, it was an open question as to whether the Court would continue to reinforce the liability shield or whether the hint of a new direction set forth in *Lamar Homes* would prevail. The Court analyzed the entire line of cases discussing the economic loss rule and concluded that the ELR was overused as a shield from liability leaving no recourse for parties who have been injured by others in the market place. In making this determination, the Supreme Court stated:

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

Sharyland v. Alton, 2011 Tex. LEXIS at *30-*31.

The Court continued its criticism of the Court of Appeals by stating:

> "The court of appeals' blanket statement also expands the rule, deciding a question we have not—whether purely economic losses may ever be recovered in negligence or strict liability cases. This involves a third formulation of the economic loss rule, one that does not lend itself to easy answers or broad pronouncements. *Id.* (Noting that outside the realm of product- or contract-related claims, 'the operation of the economic loss rule is not well mapped, and whether there is a 'rule' at all is a subject of contention')."

This language signaled the Court's frustration with the development of the economic loss rule and how there is no uniform rule at all. *Id.* at *16. The Court pointed out the historic roots of the rule in the realm of products liability and its intent to preclude recovery in tort where the damages claimed were to the product itself. *Id.* at *17.

However, just as it seemed the Supreme Court was to truly make a restrictive pronouncement on the issue of the Economic Loss Rule, the Court said the following:

> "This is an area we need not explore today, however, because the Court of Appeals erred in concluding that Sharyland's water system had not been damaged. *See* 277 S.W.3d at 154 (noting that the sewer lines had not corroded the waterlines). Sharyland's system once complied with the law, and now it does not. Sharyland is contractually obligated to maintain the system in accordance with state law and

must either relocate or encase its water lines." *Id.*

Clearly the Court's dicta indicates that the Court of Appeals decision went too far and seemed critical of the application of the ELR in recent years. However, the Court specifically stated that this is an area that did not need to be explored for this case. In other words, regardless of the formulation of the Rule (presumably using it exactly as the Court of Appeals recited it), the Supreme Court concluded that Sharyland <u>*did*</u> have property damage outside of the scope of the contract. In other words, the decision was based upon the Court's application of the facts to the law, not necessarily on the Court's interpretation of the law itself.

E. Supreme Court Decision on Third-Party Beneficiary Status:

The Supreme Court went on an upheld the Court of Appeals regarding whether or not Sharyland qualified for status as a third-party beneficiary to the contract, and thus, avoided the economic loss rule entirely by bringing a direct contract action.

This argument has been a common tool for property owners to attempt to bring direct actions against subcontractors who have evaded tort liability under the ELR and with whom there is no direct contractual privity.

Texas law has explored this issue in tandem with application of the ELR for some time. Generally speaking, a third-party, that is, a party who is not a signatory to the contract, may sue on a contract made by others only if: (a) the contracting parties intended to secure a benefit for the third-party, and (b) *the contracting parties entered into the contract primarily and directly for benefit of the third-party. Dorsett Bros. Concrete Supply, Inc. v. Safeco Title Ins. Co.,* 880 S.W.2d 417, 421 (Tex. App.-Houston [14th Dist.] 1993, writ denied). Further, certain courts have stated that courts <u>must</u> presume there are no third-party beneficiaries to written contracts. *Corpus Christi Bank & Trust v. Smith,* 525 S.W.2d 501, 503-04 (Tex. 1975). In other words, the trial court's analysis "must begin with the presumption that parties contract for themselves, and a contract will not be construed as having been made for the benefit of third parties unless it clearly appears that such was the intention of the contracting parties." *Id.*

This has been specifically applied in construction contracts, where courts have held that property owners are not third-party beneficiaries to the contracts between general contractors and their subcontractors. *M.D. Thomson and Austin Banister Joint Venture, v. Espey Huston & Associates, Inc.,* 899 S.W.2d 415, 419 (Tex. App. -- Austin 1995, no writ). Subcontracts are entered into to enable the general contractor to perform its obligations under the general contract between the general contractor and the owner. *Id.* at 419. Performance by the subcontractor, however, does not discharge the general contractor of its duties to the owner. *Id.* By way of example, "the installation of plumbing fixtures or the construction of cement floor by a subcontractor is not a discharge of the [general] contractor's duty to the owner to deliver a finished building with those items." *Id.* The owner, on the other hand, has no rights against the subcontractor "in the absence of clear words to the contrary." *Id.* The benefit that the owner receives from the subcontractor's performance "must be regarded as merely incidental." *Id.*

Instead, to be entitled to sue a subcontract, the property owner must establish not only that it directly benefited from the subcontract, but also that the subcontract was entered into by the general contractor and the subcontractor *directly and primarily for the benefit of the property owner. Id.* In making the determination whether a subcontract was made "directly and primarily for the benefit of the property owner," the court must resolve all doubts against finding the existence of a third-party beneficiary. *See, Curtis Raymond v. Marcel Rahme and Williams Investments,* 78 S.W.3d 552, 561 (Tex. App. -- Austin 2002). In other words, *"absent clear evidence to the contrary,* a property owner is not considered a third-party beneficiary of a contract between the general contractor and a subcontractor." *Id.* (emphasis added).

The Supreme Court in *Sharyland* did nothing to disturb this line of cases. In fact, the Court appeared to extend this line further holding that "the fact that a person is directly affected by the parties' conduct, or that he 'may have a substantial interest in a contract's enforcement, does not make him a third-party beneficiary.'" See *Sharyland*, 2011 WL 5042023 at 10. (Citing *Fleetwood Enters. Inc. v. Gaskamp,* 280 F.3d 1069, 1075 (5th Cir.2002) (applying Texas law and quoting *Loyd v. ECO Res., Inc.,* 956 S.W.2d 110, 134 (Tex.App.-Houston [14th Dist.] 1997, no pet.)).

The Supreme Court concluded that:

> "because the contracts entered into between Alton and the contractors make no reference to Sharyland and indicate no intention to confer a benefit on it, we agree with the court of appeals that Sharyland was not a third party beneficiary of those contracts." *Sharyland*, 2011 WL 5042023 at 10.

As such, while the Supreme Court seemed more eager to curtail the use of the ELR as a shield from tort liability, they seemed to hold zero interest in expanding contractual liability through use of third party beneficiary status.

V. CONCLUSION: THE POST-*SHARYLAND* LANDSCAPE:

Many commentators post-*Sharyland* have suggested that we have entered a new era of the economic loss rule in Texas. They have surmised that the use as a shield for liability from subcontractors has been greatly curtailed.

Clearly, the Supreme Court signaled that they have come to the opinion that the economic loss rule's interpretation by the intermediate Courts of Appeal has become too expansive. However, this does not necessarily signal that the ELR cannot be used in the context of construction defect claims.

The language of the Supreme Court is quite strong, but they elected to decide the case and overrule the Court of Appeals based upon what could easily be considered a classic interpretation of the *Reed/Testbank* line of cases. The general basis for the Supreme Court's decision to reverse the earlier City of Alton case was that Sharyland's waterlines now required upgrades and modifications that were not necessary prior to the installation of the sewerline project. Clearly, the waterlines were not in the scope of the contract. Thus, the Supreme Court simply ruled that this is damage to a contractual stranger that was not the subject of a contract. It seems very easy to reconcile this decision with past cases in the *Reed/Testbank* line.

However, the Court did make the commentary in dicta, in particular, drawing upon the roots of the doctrine as a products liability rule. In fact, the Supreme Court said:

> Thus, we have applied the economic loss rule only in cases involving defective products or failure to perform a contract. In both of those situations, we held that the parties' economic losses were more appropriately addressed through statutory warranty actions or common law breach of contract suits than tort claims. Although we applied this rule even to parties not in privity (*e.g.* a remote manufacturer and a consumer), we have never held that it precludes recovery completely between contractual strangers in a case not involving a defective product—as the court of appeals did here.

Sharyland, 2011 WL 5042023 at 8.

This is the type of language that signals that the Supreme Court is truly ready for a shift in dogma on the economic loss rule. The fact is that *Sharyland*'s facts did not require the Court to make such broad and sweeping pronouncements. This is a clear indicator that the Court is going to restrict the use of the ELR as a shield – especially if the claimed damage is NOT the subject matter of a contract entered into by the Plaintiff, as is the case in Sharyland. This is an issue that will require close scrutiny in the coming months from the appellate courts and we will see to what extent Sharyland restricts the

use of the economic loss rule by subcontractors in the context of construction defect litigation.