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The Economic Loss Rule and the Design Professional's Liability in Texas

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NOTES

THE ECONOMIC LOSS RULE AND THE DESIGN PROFESSIONAL'S LIABILITY IN TEXAS

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ABSTRACT

The economic loss rule bars recovery by a party who suffers only economic loss, unaccompanied by harm to the person or property. Although the economic loss rule was developed as a way to maintain a "boundary line" between contract and tort law, the application of the rule has proven difficult because of its potential for broad applicability and inequitable results. Because of this, several jurisdictions across the United States have adopted exceptions to the general economic loss rule. One such exception is negligent misrepresentation. The negligent misrepresentation exception is outlined in section 552 of the Second Restatement of Torts. The exception provides that a person who conveys negligent information in the course of his or her business for the guidance of persons within a limited class, who then rely on that information to their detriment, are liable to those persons in tort notwithstanding the economic loss rule. Until recently, Texas law was unclear as to whether it had adopted negligent misrepresentation as a general exception to the economic loss rule. It is clear, however, that Texas has adopted an exception to the economic loss rule for professionals who provide negligent information in the course of their profession. The Court in LAN/STV v. Martin K. Eby Constr. Co. ("LAN/STV") chose not to extend this exception to design professionals who provide negligent design plans to contractors for a construction project. This decision has received backlash by many in the construction industry as it produces inequitable results and does not extend the "professional" exception to design professionals. Texas should adopt the negligent misrepresentation exception to the economic loss rule, as applied to design professionals in the construction context, so that tort remedies are available to contractors who suffer economic losses due to their reliance on negligent plans from a design professional.

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I. Introduction

The construction business depends on specialized information, and the fundamental role of a design professional on a construction project is to provide information for the guidance of the contractor. What happens when the design professional provides the contractor with faulty information, or information so poor and full of gaps that it might as well be false? The Texas Supreme Court answered this question through the *LAN/STV v. Martin K. Eby Constr. Co.*[1] decision—contractors who suffer pecuniary loss due to their reliance on a design professional's negligently misrepresented design plans are barred by the economic loss rule from recovering against the design professional in tort.[2]

The economic loss rule developed as a way to maintain a boundary between contract and tort law,[3] but the application of the rule has

1. LAN/STV v. Martin K. Eby Constr. Co., 435 S.W.3d 234 (Tex. 2014).
2. *See id.* at 249–50.
3. *Id.* at 240 (citing Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 Wash & Lee L. Rev. 523, 554 (2009)).

proven difficult. Stated simply, "the 'economic-loss rule' bars recovery in tort when a party suffers economic loss unaccompanied by harm to his own person or property."[4] The economic loss rule has broad applicability and is often accompanied by a wide range of exceptions to resolve potential inequitable results, including an exception for negligent misrepresentation.[5] Prior to the *LAN/STV* decision, Texas case law was unclear as to whether the negligent misrepresentation exception had been adopted. However, following the *LAN/STV* decision it appears that the Texas Supreme Court has rejected a general negligent misrepresentation exception to the economic loss rule, and specifically rejected the exception in the construction context.[6] This Note proposes that Texas adopt the negligent misrepresentation exception to the economic loss rule in the construction context where a design professional provides negligent information to the contractor on a project, resulting in economic losses.

Part II of this Note sets forth the background of the economic loss rule, the two major rationales for its application, and its potential for inequitable results. Although the economic loss rule provides an important boundary between contract and tort law and protects tortfeasors from boundless liability,[7] it also has the potential to produce inequitable results.[8] Part II of this Note discusses the adoption of the negligent misrepresentation exception to the economic loss rule as a means to prevent these inequitable results.

Part III of this Note discusses Texas case law concerning the status of the negligent misrepresentation exception to the economic loss rule. Prior to the *LAN/STV* decision, Texas case law was murky as to whether the misrepresentation exception had been adopted.[9] Several Texas courts have adopted the exception in regard to professionals, while other Texas courts have not.[10]

Part IV of this Note examines the facts and holding of the Texas Supreme Court in *LAN/STV* and evaluates whether the economic loss rule prevents a general contractor from recovering pecuniary damages caused by the design professional's negligent misrepresentation of the project's plans and specifications. The Court rejected the negligent

4. Wiltz v. Bayer CropScience, LP, 645 F.3d 690, 695 (5th Cir. 2011).

5. *See, e.g.*, Barber Lines A/S v. M/V Donau Maru, 764 F.2d 50, 56 (1st Cir. 1985).

6. *See LAN/STV*, 435 S.W.3d at 247 (citing RESTATEMENT (THIRD) OF TORTS § 6, cmt. b (AM. LAW INST., Tentative Draft No. 2, 2014)).

7. Jim Wren, *Applying the Economic Loss Rule in Texas*, 64 BAYLOR L. REV. 204, 214 (2012).

8. *See Barber Lines*, 764 F.2d at 57.

9. *See infra* Part II.

10. Charles E. Fowler, Jr., *The Economic Loss Rule and Its Application to the Tort of Negligent Misrepresentation in Texas*, 18 TEX. WESLEYAN L. REV. 893, 904 (2012); Grant Thornton LLP v. Prospect High Income Fund, 314 S.W.3d 913, 920 (Tex. 2010) (noting the negligent misrepresentation exception in causes of action "legitimately brought against auditors, accountants, and other professionals").

misrepresentation exception as applied to design professionals, holding that the contractor's sole remedy should be found in contract rather than tort.[11]

In Parts V and VI of this Note, the potential inequities and negative implications imposed by the *LAN/STV* decision are countered by a proposal for Texas to adopt the negligent misrepresentation exception to the application of the economic loss rule. Part V explores case law and rationale from jurisdictions that have adopted the negligent misrepresentation exception where professionals or "special relationships" are involved.[12] Part VI provides public policy and practical considerations that support the adoption of the negligent misrepresentation exception. Although several inequities would result from the broad application of the economic loss rule, this Note discusses the potential implications of discouraging responsibility in the production of design plans by design professionals,[13] prejudicing unsophisticated parties,[14] and overlooking the large class of public works projects where contractual bargaining is impossible.[15]

II. Economic Loss Rule and Negligent Misrepresentation

The economic loss rule is defined as a bar on recovery in a tort action when a "party suffers economic loss unaccompanied by harm to his own person or property."[16] However, there is no universal economic loss rule, and Texas courts have often struggled with its applicability, specifically in the context of negligent misrepresentation.[17] Although several courts have oversimplified the economic loss rule by stating that it bars recovery of pure economic losses by parties who are not in contractual privity, this interpretation is not completely accurate.[18] The Texas Supreme Court has indicated that a reference to a single economic loss rule is a "misnomer" because "there is not one economic loss rule broadly applicable throughout the field of torts."[19] Rather, in various areas of the law, there are several variations of the economic loss rule that are governed by limited rules.[20] The applica-

11. *LAN/STV*, 435 S.W.3d at 249–50.

12. *See infra* Part V; *see also* Mark M. Schneier, Annotation, *Tort Liability of Project Architect or Engineer for Economic Damages Suffered by Contractor or Subcontractor*, 61 A.L.R.6th 445 § 2 (2011).

13. *See infra* Section VI.A; *see also* Alan Devlin, Fundamental Principles of Law and Economics 85–86 (2014).

14. *See infra* Section VI.B; *see also* Restatement (Third) of Torts § 3, cmt. f (Am. Law Inst., Tentative Draft No. 1, 2014).

15. *See infra* Section VI.C. *See generally* Tex. Loc. Gov't Code § 252.043 (West Supp. 2014) (detailing the procedure for awarding government contracts).

16. Wiltz v. Bayer CropScience, LP, 645 F.3d 690, 695 (5th Cir. 2011).

17. Wren, *supra* note 7, at 207 (citing Johnson, *supra* note 3, at 534–35).

18. *See id.* at 212–13.

19. Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 415 (Tex. 2011) (quoting Johnson, *supra* note 3, at 534–35).

20. *Id.*

tion of the economic loss rule in relation to the tort of negligent misrepresentation is an example of a situation governed by one of these limited rules.[21]

The Second Restatement of Torts section 552 ("section 552"), labeled "Information Negligently Supplied for the Guidance of Others," provides a tort remedy for individuals that lose money due to another's negligent misrepresentation within the context of a business transaction.[22] Section 552 provides for the liability of professionals who fail to exercise reasonable care in communicating information to a third party knowing that the third party will rely on the information.[23] Under section 552, the third party has a claim for negligent misrepresentation regardless of whether the individual is in contractual privity with the person who provided the information.[24] For example, comment g of section 552 provides that a third party will have a claim for negligent misrepresentation even if the defendant does not *directly* communicate the faulty information to him or her.[25] Comment g further provides that it is unnecessary that the defendant actually know the identity of the third party to whom the information is provided, so long as the defendant intends that the information will influence and be relied upon by a discrete class of persons, separate from the larger class of persons that will eventually be reasonably expected to have access to the information.[26]

Section 552B of the Second Restatement of Torts, labeled "Damages for Negligent Misrepresentation," provides the damages that are

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21. *See id.*

22. RESTATEMENT (SECOND) OF TORTS § 552 (AM. LAW INST. 1977). This section states:

> (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 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 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.

Id.

23. *Id.*

24. *See id.* A defendant is liable to a limited class of potential plaintiffs that justifiably relies on the false information communicated by the defendant. *Id.*

25. *Id.* at cmt. g.

26. *See id.*

recoverable for a claim of negligent misrepresentation.[27] Damages available under section 552B include "pecuniary loss suffered . . . as a consequence of the plaintiff's reliance upon the misrepresentation," but exclude damages recoverable through the benefit of a contract with the defendant.[28] It is important to note that a claim for negligent misrepresentation is an independent injury for pecuniary damages that are above, beyond, and apart from any damages available through contract law.[29] Therefore, if a plaintiff can prove an action for negligent misrepresentation, he or she is entitled to "economic out-of-pocket losses," regardless of whether he or she is in contractual privity with the defendant.[30] However, the plaintiff cannot receive "benefit-of-the-bargain damages" that arise from the subject matter of a contract, as these are separate remedies recoverable in contract rather than in tort.[31]

There are two major rationales for the application of the economic loss rule: (1) to protect the boundary between tort and contract law; and (2) to protect tortfeasors whose actions are not related to contract from boundless liability.[32]

A. *Protection of the Boundary Line Between Tort and Contract Law*

The first and most common rationale for the application of the economic loss rule is to protect the boundary between contract and tort law, providing deference to bargained-for contracts.[33] This rationale is based on the theory that when parties are in contractual privity with each other, the contract—not the law of torts—should control damage awards because the parties have had the opportunity to bargain and allocate the risks of economic harm.[34] Allowing tort law to control in situations involving pure economic losses, rather than the contract the parties agreed on, has the potential to undermine the role of contract law.[35] As one commentator poignantly has noted, "Quite simply, the

27. *Id.* § 552B.

28. *Id.* Pecuniary damages are available only for those damages that are not recoverable under a contract. *See id.*

29. CCE, Inc. v. PBS & J Constr. Servs., Inc., 461 S.W.3d 542, 550 (Tex. App.—Houston [1st Dist.] 2011, pet. denied).

30. *Id.* at 549–50.

31. *See id.* at 546–47.

32. *See* Wren, *supra* note 7, at 214–18 (discussing the two major rationales for applying the economic loss rule).

33. *See* Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 12–13 (Tex. 2007).

34. *See* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 872–73 (1986).

35. *See id.* at 874.

economic loss rule 'prevent[s] the law of contract and the law of tort from dissolving one into the other.'"[36]

B. *Protection of Tortfeasors from Unlimited Liability to an Indeterminate Class*

In situations where contractual privity is not present, a growing minority of jurisdictions have applied the economic loss rule due to the potential for boundless liability and "disproportionality" between liability and fault that can otherwise occur.[37] For example, the First Circuit adopted this approach, justifying its application of the economic loss rule by explaining that unlike traditional damages for physical harm, which are limited in scope and in the class of individuals harmed, damages for pure economic damages are often far less foreseeable as to the class of individuals and the extent of damages.[38] Jurisdictions that have adopted this rationale consider the risk significant that a tortfeasor could be held liable by an unlimited amount of plaintiffs that he or she is not in contractual privity with as it "threatens to raise significantly the cost of even relatively simple tort actions."[39]

III. Has Texas Adopted Section 552?

Texas courts have followed section 552 when applying the economic loss rule in negligent misrepresentation suits.[40] Texas courts have adopted the "intermediate scope" standard set forth in section 552, rather than the "near-privity" or "foreseeability" standards that have been adopted in other jurisdictions.[41] The "intermediate scope" standard or "Restatement" standard is broader than the "near-privity" standard because it does not require the provider of negligent information to know the precise identity of the third-party who will rely on the information.[42] The "intermediate scope" standard, on the other hand, is narrower than the "foreseeability" standard, because it is re-

36. Wren, *supra* note 7, at 217 (quoting R. Joseph Barton, Note, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 Wm. & Mary L. Rev. 1789, 1796 (2000)).

37. *Id.* at 218; Schneier, *supra* note 12, § 9.

38. *See, e.g.*, Barber Lines A/S v. M/V Donau Maru, 764 F.2d 50, 54 (1st Cir. 1985).

39. *Id.*

40. Fowler, *supra* note 10, at 904.

41. Robert K. Wise & Heather E. Poole, *Negligent Misrepresentation in Texas: The Misunderstood Tort*, 40 Tex. Tech. L. Rev. 845, 852 (2008).

42. *Id.* at 849 (identifying the near-privity standard as a "relationship sufficiently intimate to be equated with privity" (quoting Credit All. v. Arthur Anderson & Co., 483 N.E.2d 110, 112 (N.Y. 1985))). The near-privity standard requires three elements: (1) that the information provider must have known that the misinformation would be used in a specific transaction or for a specific purpose; (2) that the information provider must have known that the misinformation would be relied on by a third party; and (3) some conduct by the information provider linking it to the third party that

stricted to a limited class of persons rather than all third parties whose reliance is reasonably foreseeable.[43] Under the "intermediate scope" or "Restatement" standard, protection extends to the limited class of persons that the provider of information actually intends to receive and be guided by the information, or should know will receive and be guided by it, regardless of whether the provider of information knows their specific identity.[44]

A. *Texas Cases that Follow the Restatement*

Texas courts have adopted section 552 in several instances. The first Texas court to apply section 552 was the Fort Worth Court of Civil Appeals in *Shatterproof Glass Corp. v. James*.[45] Following *Shatterproof Glass*, the Texas Supreme Court adopted section 552 on two additional occasions: first in *Federal Land Bank Ass'n v. Sloane*[46] and then again in *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*.[47] In *McCamish*, the issue was whether a nonclient could sue an attorney for negligent misrepresentation.[48] The Texas Supreme Court strictly followed section 552, holding that the attorney would be liable for the nonclient's pecuniary losses because "the attorney who provid[ed] the information [was] aware of the nonclient and intend[ed] that the nonclient rely on the information."[49] The Court in *McCamish* also noted that Texas courts have applied section 552 to a variety of other professionals, and, therefore, could not "perceive [any] reason why section 552 should not [also] apply to attorneys."[50] The Court also considered whether section 552 applied uniformly across professional lines, or if it was limited to attorneys.[51] The Court

evinces the provider's understanding that the third party would rely on the misinformation. Wise & Poole, *supra* note 41, at 849–50.

43. Wise & Poole, *supra* note 41, at 850–51 ("The courts of three jurisdictions, Mississippi, New Jersey, and Wisconsin have adopted the foreseeability standard for negligent misrepresentation.").

44. *Id.* at 852, 860 (noting that the Fifth Circuit, in a 2-1 panel decision, declined to certify the question "whether Texas uses actual knowledge requirement or foreseeability test for negligent misrepresentation" because the "Texas Supreme Court has adopted the Restatement" (citing Compass Bank v. King, Griffen & Adamson, PC, 388 F.3d 504, 505 & n.1 (5th Cir. 2004)).

45. Shatterproof Glass Corp. v. James, 466 S.W.2d 873, 875–80 (Tex. Civ. App.—Fort Worth 1971, writ ref'd n.r.e.) (adopting the RESTATEMENT (SECOND) OF TORTS § 552 tentative draft that contains the same language as the current version).

46. Fed. Land Bank Ass'n v. Sloane, 825 S.W.2d 439, 442 (Tex. 1991) ("We agree with the Restatement's definition [of negligent misrepresentation].").

47. McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787, 791 (Tex. 1999).

48. *Id.*

49. *Id.* at 794; *see also* Wise & Poole *supra* note 41, at 858. The court in *McCamish* held that absent privity an attorney could be held liable to a third-party for negligent misrepresentation under the Restatement Second of Torts section 552. *McCamish*, 991 S.W.2d at 791.

50. *McCamish*, 991 S.W.2d at 791.

51. Wise & Poole, *supra* note 41, at 859 (citing *McCamish*, 991 S.W.2d at 791).

did not distinguish between the types of professionals that could be liable for negligent misrepresentation but held that it applies *evenly to all categories of professionals*.[52]

In 2011, the Houston Court of Appeals in *CCE, Inc. v. PBS & J Construction Services Inc.* ("*CCE, Inc.*"),[53] strictly followed sections 552 and 552B, outlining the requirements for damages in a negligent misrepresentation suit.[54] In *CCE, Inc.*, a general contractor on a road construction project sued a design professional for negligently representing the design plans.[55] As in most design-for-build construction contracts, the design professional and contractor were in contractual privity with the project owner, but not with each other.[56] The design professional submitted design plans to the owner of the project and the general contractor relied on these plans when bidding on and completing the project.[57] The flaws in the design plans caused the contractor to suffer immense out-of-pocket damages.[58] The First District Court of Appeals held in favor of the general contractor because the contractor's claim for "damages [was] actually for its 'pecuniary loss suffered otherwise as a consequence of [the contractor's] reliance upon the misrepresentation[s]'" since the court quoted the Restatement (Second) of Torts when it said, "pecuniary loss suffered otherwise as a consequence of [the contractor's] reliance upon the misrepresentation[s]" of design professional's design plans.[59] Specifically, the contractor provided evidence that it paid over $2 million in out-of-pocket expenses to complete the construction project—expenses that were additional to what it would have cost the contractor to complete the project absent the design professional's negligent misrepresentation of the design plans.[60]

B. *Texas Cases that Do Not Follow the Restatement*

Although some Texas courts have followed section 552 allowing damages for pecuniary loss for a negligent misrepresentation claim, other Texas courts have also invoked the economic loss rule as a bar to negligent misrepresentation claims.

In the 2010 case *Grant Thornton LLP v. Prospect High Income Fund*, bond and hedge fund investors brought suit against an auditing firm based upon its audit of Epic, a company that sold bonds to inves-

52. *See id.*
53. CCE, Inc. v. PBS & J Constr. Servs., Inc., 461 S.W.3d 542 (Tex. App.—Houston [1st Dist.] 2011, pet. denied).
54. *See id.* at 544.
55. *Id.* at 545.
56. *See id*.
57. *See id.* at 545–46.
58. *Id.*
59. *Id.* at 551 (quoting RESTATEMENT (SECOND) OF TORTS § 552B(1)(b) (AM. LAW INST. 1977)).
60. *Id.*

tors.[61] Epic employed Grant Thornton to audit and review its financial statements for the years 1999 and 2000.[62] Although Epic had not complied with escrow account requirements, Grant Thornton issued reports in 2000 and 2001 that confirmed Epic's continued compliance—a negligent misrepresentation.[63] The hedge fund investors sued Grant Thornton alleging that "the auditor's reports misrepresented the escrow account status."[64] The Texas Supreme Court discussed the auditor's liability to third parties under section 552 and held that a cause of action for negligent misrepresentation is only available when the information is provided to a "known party for a known purpose."[65] Specifically, the Court, quoting the Restatement, described a "known party" as limited persons "for whose benefit and guidance [one] intends to supply the information or knows that the recipient intends to supply it."[66] The hedge fund investors argued that they were within the limited class of investors in the market who actually purchased the bonds at issue.[67] The Texas Supreme Court, however, held that the investors were not part of the limited class described in section 552 because the bonds were sold on the open market and the investors had no previous connection to Epic or Grant Thornton.[68] Considering the lack of connection to Grant Thornton, the Court explained that to allow the investor's negligent misrepresentation claim to prevail would "eviscerate the Restatement rule in favor of a de facto foreseeability approach—an approach [the Court has] refused to embrace."[69] The Court applied the economic loss rule because the relationship between the auditors and the investors did not meet the "intermediate scope" or "Restatement" standard for liability.

In the 1998 case *D.S.A., Inc. v. Hillsboro Independent School District* ("*D.S.A.*"), the Texas Supreme Court denied recovery for pecuniary damages and invoked the economic loss rule.[70] In *D.S.A.*, a construction firm contracted with Hillsboro Independent School District to supervise the building of a new school.[71] The school district

61. Grant Thornton LLP v. Prospect High Income Fund, 314 S.W.3d 913, 915–16 (Tex. 2010).

62. *Id.* at 916.

63. *See id.* at 916–17.

64. *Id.* at 917.

65. *Id.* at 920–21 (holding that the Restatement standard of "foreseeability" was not met because the investment bankers were not within the limited class that the auditor knew, or should have known, would rely on the information).

66. *Id.* (quoting RESTATEMENT (SECOND) OF TORTS § 552(2)(a) (AM. LAW INST. 1977) (alteration in original)).

67. *Id.* at 921.

68. *Id.*

69. *Id.* (discussing that Texas has refused to adopt a mere foreseeability standard and has instead adopted the "Restatement view" or "intermediate-scope standard" when determining liability to third parties); *see also* RESTATEMENT (SECOND) OF TORTS § 552 (AM. LAW INST. 1977).

70. *See* D.S.A., Inc. v. Hillsboro Indep. Sch. Dist., 973 S.W.2d 662, 663 (Tex. 1998).

71. *Id.*

subsequently sued the construction firm for negligent misrepresentation of the functions it would perform under the contract, but the Court barred the claim because the school district failed to demonstrate any injury independent of contract damages.[72] The Court applied the economic loss rule as a bar to recovery because the school district did not attempt to distinguish its out-of-pocket damages from the contractual damages it was eligible to receive.[73] The Court held that allowing the school district to recover for the benefit of its bargain through tort "would potentially convert every contract interpretation dispute into a negligent misrepresentation claim."[74] Notably, the Court did not hold that tort damages could never be recovered, but only that the damages could not be recovered in this case because the damages were recoverable by contract.[75]

IV. *LAN/STV v. Martin K. Eby Constr. Co.*: Case Summary

The question presented in this case was whether the economic loss rule allowed a general contractor to recover pecuniary damages incurred from a design professional's negligent misrepresentation of the project's plans and specifications.[76]

A. *Facts*

The Dallas Area Rapid Transportation Authority ("DART") contracted with LAN/STV, a design professional (architect), to prepare construction plans and specifications for a light-rail transit line.[77] DART received and incorporated the plans from LAN/STV into its solicitation of general contractors to construct the light-rail transit line.[78] Martin K. Eby Construction Company ("Eby") relied on the design specifications when making its bid and was awarded the contract.[79] Eby had previous experience constructing light-rail transit lines, specifically the company had built two other DART light-rail projects, one of which was designed by LAN/STV.[80]

As is typical in construction contracts, DART contracted separately with LAN/STV and Eby—LAN/STV and Eby did not enter into a contract with each other.[81] Upon beginning construction, Eby discovered that the plans designed by LAN/STV were ridden with errors,

72. *Id.* at 663–64.
73. *Id.*
74. *Id.* at 664.
75. *See id.*
76. LAN/STV v. Martin K. Eby Constr. Co., 435 S.W.3d 234, 236 (Tex. 2014).
77. *Id.*
78. *Id.*
79. *See id.*
80. Transcript of Oral Argument, LAN/STV v. Martin K. Eby Constr. Co., 435 S.W.3d 234 (Tex. 2014) (No. 11-0810) [hereinafter Transcript of Oral Argument] (relying on the design plans to be as accurate as they had been in previous projects).
81. *LAN/STV*, 435 S.W.3d at 236.

resulting in adjustments or changes needed throughout 80% of the plan.[82] The errors disrupted the construction process, requiring new materials and labor that Eby did not anticipate based on the design plans it relied upon when submitting its bid.[83] Overall, Eby calculated that it lost $14 million on the project as a result of its reliance on LAN/STV's design plans.[84]

Eby filed a suit against LAN/STV on the grounds of negligence and negligent misrepresentation.[85] The only claim that went to the jury for deliberation was that LAN/STV negligently misrepresented the work to be done through its flawed design plans.[86] The trial court rendered judgment for Eby in the amount of $2.25 million, plus interest.[87] Both parties appealed the trial court's judgment, and the Dallas Court of Appeals affirmed.[88] Both LAN/STV and Eby petitioned and were granted review by the Supreme Court of Texas.[89] The Court reviewed only LAN/STV's argument that the economic loss rule barred Eby's recovery of economic losses for the alleged negligent misrepresentation.[90]

B. *Analysis*

The Court first looked at the history and development of the economic loss rule in the United States and its current status in Texas to determine whether it could apply as a limitation on Eby's ability to recover pure economic losses.[91]

The Court examined the 1927 case *Robins Dry Dock & Repair Co. v. Flint*,[92] as an early example of a court limiting recovery of pure economic damages for a negligence claim.[93] In *Robins*, charterers were delayed using a steamship because of the dry dock's negligence, which failed to make timely repairs to the vessel.[94] The charterers sued the dry dock for economic damages that they incurred because of the delay.[95] The *Robins* Court held that the charterers could not re-

82. *Id.*; *see also* Transcript of Oral Argument, *supra* note 80. Generally, contractors expect about 10% of the designs will need adjustment; in this case 80% of the designs needed adjustment. *LAN/STV*, 435 S.W.3d at 236.

83. *LAN/STV*, 435 S.W.3d at 236.

84. *See id.*

85. *Id.* at 237. Because LAN/STV and Eby were not in contractual privity, Eby's only recourse was through tort, not contract. *See id.* at 249–50.

86. *Id.* at 237.

87. *Id.* (finding that Eby, DART, and LAN/STV all contributed to the overall $5 million in damages and apportioning 45% of the responsibility to LAN/STV, 40% to DART, and 15% to Eby).

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.* at 237–38.

92. Robins Dry Dock & Repair Co. v. Flint, 275 U.S. 303 (1927).

93. *LAN/STV*, 435 S.W.3d at 238.

94. *Id.*

95. *Id.*

cover damages resulting from the dry dock's negligence because the dry dock and the charterers had no contract with each other—only the owner of the vessel and the dry dock had a contract.[96] The case emphasized that the owner's contract with the dry dock created no duty upon the dry dock to third-party charterers; whether the work was performed negligently was only the "business of the owners and of nobody else."[97]

The Court then looked to Judge Higginbotham's explanation of the economic loss rule and its purpose in *State of Louisiana v. M/V Testbank*,[98] nearly sixty years after the *Robins* decision.[99] Judge Higginbotham cites Professor Fleming James' 1972 article, *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, which explains that judges have been reluctant to allow recovery for pure economic losses because of the uncertainty concerned with what a jury may or may not find to be foreseeable.[100] Judge Higginbotham further notes that unlike negligence, which results in physical damages that are limited by the scope of the injury, indirect economic losses can be unlimited, far-reaching, and "virtually open-ended."[101] According to Judge Higginbotham, the remedy of risk allocation through contract and insurance is more favorable to judges who are reluctant to allow recovery for pure economic losses because contract damages are foreseeable as to class and scope.[102]

The Court then examined Vincent R. Johnson's view on the desirability of the economic loss rule as a remedy in comparison to contract and insurance.[103] Vincent R. Johnson notes that the economic loss rule acts as an important "boundary-line . . . separating the law of torts from the law of contracts . . . in circumstances where both theories could apply."[104] According to Justice Blackmun, a victim who suffers from pure economic losses should find his or her remedy "entirely [in the] law of contracts" because in contract law "both parties may set the terms of their own agreements."[105]

96. *Id.* (citing the holding in *Robins* that absent privity of contract, there can be no suit for negligence to a third party).

97. *Id.* (quoting *Robins*, 275 U.S. at 308–09).

98. Louisiana v. M/V Testbank, 752 F.2d 1019 (5th Cir. 1985).

99. *LAN/STV*, 435 S.W.3d at 238 (citing Fleming James Jr., *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43, 43 (1972)).

100. *Id.* at 239 (quoting James, *supra* note 99, at 44).

101. *Id.* (citing James, *supra* note 99, at 45).

102. *Id.* at 239.

103. *See id.* at 239–40 (examining Judge Posner's view on the economic loss rule's application to negligence claims).

104. *Id.* at 240 (quoting Johnson, *supra* note 3, at 546).

105. *Id.* at 239 (citing E. River S.S. Corp. v. Transamerica Delavel, Inc., 476 U.S. 858, 859 (1986)).

The Court then discussed two current rationales for limiting recovery through the economic loss rule.[106] The first rationale discussed is the indeterminate and disproportionate liability that is associated with pure economic losses.[107] The Court explained that a single negligent act has the ability to cause economic loss to anyone who relies on it, potentially resulting in the liability for damages that extend far beyond the negligent person's blameworthiness.[108] The second rationale discussed is deference to contract.[109] The Court explained that economic injuries often occur when individuals choose to rely on another's manifestations when entering into an economic transaction.[110] The Court explained that in economic transactions parties have the full opportunity to explore risks associated with the transaction, and either bargain for the allocation of that risk or obtain insurance.[111] The Court explained that allocating risks and responsibilities for potential economic harms through contract best serves the interests of all parties involved, providing a more accurate distribution of responsibility than a court could post-injury.[112]

The Court acknowledged that there is not a bright-line test in the application of the economic loss rule, but provided the Restatement of Torts rule that states "while there is no 'general duty to avoid the unintentional infliction of economic loss,' the duty may exist when the rationales for limiting recovery are weak or absent."[113] It also addressed that the economic loss rule as applied to actions between contractual strangers is unsettled.[114]

The Court cited to several Texas cases that have held a party can recover economic losses resulting from reliance on a professional's misrepresentations.[115] Specifically, the Court acknowledged several professional malpractice exceptions to the application of the economic loss rule, including professionals such as lenders, attorneys, and ac-

106. *Id.* at 240.
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.* at 240–41.
111. *Id.* at 241.
112. *Id.*
113. *Id.* at 241–42 (citing William Powers, Jr. & Margaret Niver, *Negligence, Breach of Contract, and the "Economic Loss" Rule*, 23 TEX. TECH L. REV. 477, 477 (1992)); *see also* Johnson, *supra* note 3, at 536 ("The confusing mass of precedent relating to tort liability for economic loss has yet to be disentangled and expressed with the clarity commonly found with respect to other tort law topics.")).
114. *LAN/STV*, 435 S.W.3d at 243; *see also* Powers & Niver, *supra* note 113, at 482 ("Although cases between contractual strangers are the paradigm of the traditional 'economic loss' rule, no Texas case involving 'strangers' expressly addresses the economic loss rule.").
115. *LAN/STV*, 435 S.W.3d at 244–45 (discussing professional malpractice as an exception to the general rule of applying the economic loss rule in actions for negligent performance of services).

countants.[116] In summary, the Court references and agrees with the Restatement view of liability for negligent misrepresentation:

> [A] plaintiff's reliance alone, even if foreseeable, is not a sufficient basis for recovery; . . . a defendant generally must act with the apparent purpose of providing a basis for the reliance. It may be useful to say that a defendant . . . must "invite reliance" by the plaintiff, so long as the expression is understood to refer to the defendant's apparent purpose and not to a temptation incidentally created by the defendant's words or acts.[117]

Eby argued that the economic loss rule should not bar its damages in this case because LAN/STV negligently misrepresented the design plans that it relied on.[118] Eby cited to *Sloane*, *McCamish*, and *Grant Thornton*, all negligent misrepresentation cases where the economic loss rule did not bar recovery for pure economic losses.[119] LAN/STV countered Eby's argument by emphasizing that the vertical nature of construction projects creates a necessity of predictability of risk-allocation through contract.[120] LAN/STV argued that if one participant to a construction project were able to recover against another that he or she is not in contractual privity with, "the risk of liability to everyone on the project would be magnified and indeterminate."[121]

Initially, the Court generally agreed with LAN/STV's argument that the vertical nature of construction contracts requires predictability through contract, explaining that the "web of contracts [involved in construction projects] would be disrupted by tort suits between subcontractors or suits brought against them by a project's owner."[122]

The Court then considered whether design professionals should be treated differently because of their status as professionals, allowing contractors who are not in contractual privity with the architect to recover economic losses based on negligent misrepresentation. The Court agreed that

> [t]he plans drawn by the architect are intended to serve as a basis for reliance by the contractor who forms a bid on the basis of them and is then hired to carry them out. The architect's plans are analogous to the audit report that an accountant supplies to a client for

116. *Id.* at 243–45.

117. *Id.* at 245 (quoting RESTATEMENT (THIRD) OF TORTS § 5, cmt.a).

118. *Id.* at 246 (arguing that construction contractors are professionals that should not be treated differently than lenders, accountants, and attorneys).

119. *Id.*

120. *Id.* (explaining that construction contracts between the participants are vertical; each participant contracts with the owner but not each other).

121. *Id.* (referencing Justice Holmes' discussion of *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303 (1927)).

122. *Id.* (citing RESTATEMENT (THIRD) OF TORTS § 6, cmt. b (AM. LAW INST., Tentative Draft No. 2, 2014)); *see also* RESTATEMENT (THIRD) OF TORTS § 6, cmt. b (AM. LAW INST., Tentative Draft No. 2, 2014) ("Allowing a suit against the architect of a project by a party who made a bid on reliance on a defective plan does not create comparable problems.").

> distribution to potential investors—a standard case of liability [for negligent misrepresentation].[123]

The Court held, however, that the contractor's principal reliance should be on the owner because the owner is the one presenting the architect's plans and the one who he or she will be in a contractual agreement with, not the architect.[124] The Court explained further that even though the contractor relies on the architect's design plans, the architect's plans are not directed to specific contractors, and are "no more [than] an invitation to all potential bidders to rely."[125]

The Court considered the effect that requiring the assignment of risk through contract could have on unsophisticated contracting parties.[126] The Second Restatement of Torts encourages the assignment of risk through contract but recognizes that it has the potential to negatively affect unsophisticated contracting parties, leaving them without remedy against another's wrong.[127] Although sophisticated parties would recognize the necessity of risk-allocation and specifying rights through contract in advance, less sophisticated parties may not recognize this necessity and could "fail to provide for indemnification . . . and inadvertently leave a party who has been wronged with no remedy."[128] The Court responded to the concern regarding parties with varying levels of sophistication, concluding that it is more likely than not that a contractor will "assume it must look to its agreement with the owner for damages" against potential misrepresentation.[129]

In conclusion, the Court held that the economic loss rule precludes contractors from recovering economic losses from a design professional in tort.[130]

V. Texas Should Adopt Section 552

It is common for construction projects to have the design and construction of the project bifurcated between a design professional and a contractor.[131] Because there is no privity between the contractor and design professional on the project, any claim by the contractor against

123. *Id.* at 246–47 (citing Restatement (Third) of Torts § 6, cmt. b (Am. Law Inst., Tentative Draft No. 2, 2014) (alteration in original)).

124. *Id.* at 247.

125. *Id.* (comparing the audit report in *Grant Thornton* and the architect's plans, concluding that the architect's plans were no more than an invitation for all potential bidders to rely rather than directed at specific contractors).

126. *Id.*

127. *Id.* at 247–48 (citing Restatement (Third) of Torts § 3, reporter's note to cmt. f (Am. Law Inst., Tentative Draft No. 1, 2012)).

128. *Id.* (citing Restatement (Third) of Torts § 3, reporter's note to cmt. f. (Am. Law Inst., Tentative Draft No. 1, 2012)).

129. *Id.* at 248 (discussing that "clarity allows parties to do business on a surer footing"); Restatement (Third) of Torts § 6, cmt. b (Am. Law Inst., Tentative Draft No. 2, 2014).

130. *LAN/STV*, 435 S.W.3d at 249–50.

131. Schneier, *supra* note 12, § 2.

the design professional must sound in tort. When a design professional provides defective design documents that cause a contractor to incur more expenses than anticipated, the contractor will naturally look to recoup some of those costs, and rightfully so. The design professional, not wanting to be financially responsible for his or her mistake, most often will seek to have the contractor's claim dismissed based on either the privity doctrine or the economic loss rule.[132] Courts in the majority of jurisdictions have held that lack of privity is not a bar to a negligence claim.[133] Courts are divided on the second issue—whether the contactor's claim for pure economic losses should be barred under the economic loss rule.[134] In *LAN/STV*, the Court held in the affirmative with regard to both, creating a bright-line distinction that fundamentally altered the availability of pecuniary damages by a contractor in a suit against a design professional for negligent misrepresentation.[135]

The Court in *LAN/STV* did not adopt section 552 as applied to the contractor's (Eby) claim for negligent misrepresentation against a design professional (LAN/STV). Instead, the Court held (1) that the plans were no more than a mere invitation for all potential bidders to rely; and (2) that Eby's reliance should have been on the project owner DART, with whom Eby was in contractual privity with, rather than the third-party design professional LAN/STV with whom he had no contract.[136]

Section 552 sets the parameters of negligent misrepresentation and the duty owed when one supplies information to others for one's own pecuniary gain, intending or knowing that others will rely on the information in the course of their business activities.[137] Negligent misrepresentation is narrowly tailored, as it applies only to those who provide information or services with the intent or knowledge that it will be relied upon by third parties; and contains a foreseeability requirement that limits the class of potential plaintiffs.[138] Modern businessmen and businesswomen rely heavily on experts and professionals for information and guidance. Although these individuals may have no contractual relationship with the expert or professional who supplies the information—and, therefore, no remedy in contract—the supplier is well aware that the information provided will be used and relied on. Section 552 reflects the modern realities of business, recognizing that

132. *See id.*

133. *Id.* (citing United States v. Rogers & Rogers, 161 F. Supp. 132 (S.D. Cal. 1958)).

134. *Id.*

135. *See LAN/STV*, 435 S.W.3d at 249–50.

136. *Id.* at 246–47. The *LAN/STV* Court applied the privity doctrine as to bar the contractor's negligent misrepresentation claims. *Id.*

137. RESTATEMENT (SECOND) OF TORTS § 552 (AM. LAW INST. 1977).

138. Bilt-Right Contractors, Inc. v. Architectural Studio, 866 A.2d 270, 286 (Pa. 2005).

information providers have a traditional duty of care, regardless of privity, for the information they supply.

A. *The Privity Doctrine*

In *LAN/STV*, the Court held that the architect owed no duty of care to the contractor because the two parties were not in privity of contract and Eby was not within the limited class of persons LAN/STV intended to rely on the design documents, as the designs were no more than an invitation for all potential contractors to rely.[139] The Court in *LAN/STV* was concerned that allowing a third party contractor to maintain a negligent misrepresentation claim against a design professional he or she is not in privity with would subject the design professional to unlimited liability to an indeterminate class.[140] The majority of American jurisdictions have eliminated the defense that an architect owes no duty of care to a contractor because of lack of privity of contract.[141] The jurisdictions that prohibit lack of privity as a defense to a tort claim have adopted section 552, which imposes a duty of care in tort regardless of the party's privity so long as the information is supplied to a "limited group of persons for whose benefit and guidance [the architect] intends to supply the information."[142] Texas has adopted the "intermediate scope standard" when applying section 552, meaning the provider of information does not need to know the precise identity of the third party who will rely on the information, but this standard entails something more than mere foreseeability of reliance.[143] Further, Texas precedent has allowed recovery for negligent misrepresentation, regardless of privity.[144] For example, in *Sharyland Water Supply Corp.*, the Texas Supreme Court stated that recovery of pure economic losses for parties not in contractual privity is recoverable in certain torts, including the tort of negligent misrepresentation.[145] The *LAN/STV* Court held that Eby could not base a claim in tort for the negligent misrepresentations made by LAN/STV, ignoring the recent precedent that allows third parties to

139. *LAN/STV*, 435 S.W.3d at 247–48.

140. *Id.* at 240.

141. Schneier, *supra* note 12, § 9 (citing an early seminal case, United States v. Rogers & Rogers, 161 F. Supp. 132 (S.D. Cal. 1959), which rejected the privity defense).

142. RESTATEMENT (SECOND) OF TORTS § 552 (AM. LAW INST. 1977); *see supra* notes 40–44 and accompanying text.

143. Wise & Poole, *supra* note 41, at 852; *see supra* notes 40–44 and accompanying text.

144. *See* Steiner v. Southmark Corp., 734 F. Supp. 269, 279–80 (N.D. Tex. 1990) (collecting Texas cases that apply the RESTATEMENT (SECOND) OF TORTS § 552 (AM. LAW INST. 1977) to negligent misrepresentations not made directly to the injured party).

145. Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 418 (Tex. 2011).

recover damages for negligent misrepresentation, regardless of privity.[146]

In a seminal case from the Southern District of California adopting section 552, a contractor sued an architect for negligent misrepresentation.[147] The district court found "[a]ltogether too much control over the contractor necessarily rests in the hands of the supervising architect for him not to be placed under a duty imposed by law to perform without negligence his functions as they affect the contractor."[148] Similarly, the Supreme Court of Pennsylvania adopted section 552 and ruled that a contractor may sue the project architect for negligent misrepresentation to recover economic losses, notwithstanding the lack of privity between the parties.[149] The court found that section 552 is narrowly focused on misrepresentations made in the context of business transactions where individuals must rely on the guidance of experts, and held that imposing liability under section 552 does nothing more than hold the supplier to a traditional duty of care.[150] Further, the court provided that architects who are hired to create designs for an owner know that the designs will be relied upon by contractors in pricing their bids; thus, the adoption of section 552 does not subject suppliers of information to unlimited liability to an indeterminate class.[151]

B. *The Economic Loss Rule—Adoption and Exceptions Generally*

Jurisdictions across the country, including Texas, are divided on whether the economic loss rule bars lawsuits brought by contractors against design professionals. According to *LAN/STV*, jurisdictions are divided 9–8 on the issue.[152] A significant number of states adopt the economic loss rule while many others reject it. In many jurisdictions, to defeat the application of the economic loss rule, contractors need to bring their claim into one of the several exceptions to the rule. The most significant exception to the economic loss rule is the Restatement of Torts "business guidance" or negligent misrepresentation exception; other exceptions include professional malpractice and special relationship.[153]

146. *Steiner*, 734 F. Supp. at 279–80.

147. *See* United States v. Rogers & Rogers, 161 F. Supp. 132 (S.D. Cal. 1958).

148. *Id.* at 136.

149. Bilt-Rite Contractors, Inc. v. Architectural Studio, 866 A.2d 270, 272 (Pa. 2005).

150. *Id.* at 286.

151. *See id.* at 285–86.

152. LAN/STV v. Martin K. Eby Constr. Co., 435 S.W.3d 234, 249 n.60 (Tex. 2014) (discussing nine cases that apply the economic loss rule and eight cases that do not).

153. Schneier, *supra* note 12, § 2.

C. *The Restatement Second of Torts Business Guidance Exception to the Economic Loss Rule*

Several American jurisdictions that have recognized a version of the economic loss rule have also adopted a "business guidance" exception to its imposition.[154] The "business guidance" exception allows a contractor to sue an architect or engineer under section 552.[155] Section 552 provides that a person, who in the course of his profession supplies faulty information for the guidance of others in a business transaction, is subject to liability for pecuniary losses caused to the person he or she provided the information to because of the person's justifiable reliance upon the information.[156] Illustration 9, comment h to section 552 provides an example of the "business guidance" exception, describing a situation where a third-party design professional negligently misrepresents information to a contractor who then relies upon that information to his or her detriment.[157] The illustration begins with a city that asks for bids for a construction project involving a sewer tunnel.[158] The city first hires a firm of engineers to make boring tests and provide a report showing the soil and rock conditions.[159] The engineering company prepares an inaccurate report that contains faulty and misleading information.[160] Based on the inaccurate information in the report, the contractor submits its bid and suffers pecuniary losses when the project costs more than expected.[161] Even though the two are not in privity of contract, the illustration concludes that the engineering company owed a duty of care and is subject to liability to the contractor for its pecuniary losses.[162]

1. LAN/STV Provided Design Plans to Guide Eby

In *LAN/STV*, the design professional LAN/STV provided design plans—80% of which were inaccurate—to DART.[163] DART then provided the inaccurate design plans to a limited class of contractors, qualified to work on light-rail transit lines, for their reliance when submitting their bids for the construction project.[164] Because the design plans were submitted by a design professional in the course of his employment for the purpose of being used by a contractor on the con-

154. *See id.* § 11 (discussing jurisdictions that have adopted the "business guidance exception" to the application of the economic loss rule).
155. RESTATEMENT (SECOND) OF TORTS § 552 (AM. LAW INST. 1977).
156. *Id.*
157. *Id.* § 552, cmt. h, illus. 9.
158. *Id.*
159. *Id.*
160. *Id.*
161. *Id.*
162. *See id.*
163. LAN/STV v. Martin K. Eby Constr. Co., 435 S.W.3d 234, 236 (Tex. 2014) (explaining that design plans on a typical project have 10% error).
164. *Id.* at 246; *see also* Transcript of Oral Argument, *supra* note 80.

struction project, it follows that the plans were submitted for the guidance of a contractor.[165]

2. Eby (the Contractor) Justifiably Relied on the Design Plans Provided by LAN/STV

DART provided Eby with the design plans for the purpose of guiding Eby, the contractor, in making its bid on the construction project, and Eby justifiably relied on these design plans when submitting its bid.[166] In *Grant Thornton*, the Court considered the element of justifiable reliance in a negligent representation claim.[167] In measuring the justifiableness of reliance, the Court considered whether at the time of the misrepresentation the plaintiff's "individual characteristics, abilities, and appreciation of [the] facts and circumstances [made it] extremely unlikely that there [was] actual reliance on the plaintiff's part."[168] The Court held that reliance is not acceptable "if there are 'red flags' indicating that such reliance is unwarranted."[169] In oral arguments prior to the judgment in *LAN/STV*, Eby's attorney argued that his client, the contractor, justifiably relied on the design plans provided by LAN/STV because Eby was not allowed to do any kind of pre-bid site inspection prior to placing the bid for the project, and therefore only had the integrity of the LAN/STV's design plans to rely on.[170] Eby's attorney further argued that Eby's reliance was justifiable because Eby and LAN/STV had a previous relationship in which they worked together on a similar light-rail line project for DART.[171] Based on this information, there is a substantial likelihood that Eby exhibited actual and justifiable reliance on the design plans provided by LAN/STV.

3. Eby Was Within the Limited Class

When considering the question of whether contractors are within the limited class for whom design professionals intend to rely, it seems significant that design professionals prepare design plans for a project with the knowledge that contractors will be required to rely on the plans. DART contracted with LAN/STV to prepare plans, drawings, and specifications to be used by prospective contractors during the construction bidding process, and later for the construction project it-

165. *See LAN/STV*, 435 S.W.3d at 247. The *LAN/STV* Court did not disagree that LAN/STV provided the design plans for the benefit of the contractor. *See id.* at 249–50.

166. *See id.* at 236–37.

167. *See* Grant Thornton LLP v. Prospect High Income Fund, 314 S.W.3d 913 (Tex. 2010).

168. *Id.* at 923 (quoting Haralson v. E.F. Hutton Grp., Inc., 919 F.2d 1014, 1026 (5th Cir. 1990)).

169. *Id.* at 923–24.

170. Transcript of Oral Argument, *supra* note 80.

171. *Id.*

self.[172] Section 552 applies to all types of professionals because professionals, knowing that others will rely, have a duty imposed by the common law to not provide false information to others in the course of their business.[173] However, this duty does not have universal applicability in that it is not to the whole world; the provider of information need not know the precise identity of the individuals who will rely on the information, but rather the limited class of individuals who will rely.[174] In oral arguments prior to the judgment in *LAN/STV*, Eby's attorney argued that LAN/STV *did* know of the class of contractors who were bidding on the project.[175] Specifically, the attorney stated that there were only five bidders and that the bidders were submitting questions to which LAN/STV was actively responding.[176] Based on this information, LAN/STV was not providing the design plans for all the contractors in the world, as the Court suggested, but rather for the limited class of five contractors bidding on this specific construction project.[177]

D. *Professional Malpractice Exception to the Economic Loss Rule*

Several jurisdictions that have adopted some version of the economic loss rule have found a "professional malpractice" exception to its imposition.[178] Jurisdictions that apply the "professional malpractice" exception acknowledge that professionals, such as accountants and attorneys, are liable for pecuniary damages suffered by third persons with whom they are not in contractual privity, and "refuse to adopt a different rule for design professionals."[179] These courts acknowledge that the common law standard of care requires professionals to exercise reasonable care in applying their skills, abilities, judgment, and at a minimum, perform their duties consistent with the way other professionals in the same field would perform under similar circumstances.[180] Specifically, the Restatement (Third) of Torts: Liability for Economic Harm section 6, comment b states:

> [T]he plans drawn by the architect are intended to serve as a basis for reliance by the contractor who forms a bid on the basis of them

172. *See LAN/STV*, 435 S.W.3d at 236.

173. Transcript of Oral Argument, *supra* note 80.

174. *Id.*; *see also supra* notes 40–44 and accompanying text.

175. Transcript of Oral Argument, *supra* note 80 (emphasis added). The attorney for Eby Construction Company explained that although section 552 does not require the information provider to know the precise identity of the limited class who will rely on the information—a higher burden, he had done so in this case. *Id.*

176. *Id.*

177. *LAN/STV*, 435 S.W.3d at 247.

178. *See* Schneier, *supra* note 12, § 15 (discussing jurisdictions that refuse to apply the economic loss rule on the ground that doing so would eviscerate professional malpractice law).

179. *Id.*

180. John W. Hays, *Construction Defect Claims Against Design Professionals and Contractors*, 23 CONSTRUCTION L. 9, at *1 (2003).

> and is then hired to carry them out. The architect's plans are analogous to the audit report that an accountant supplies to a client for distribution to potential investors—a standard case of liability for negligent misrepresentation.[181]

The *LAN/STV* Court acknowledged a professional malpractice exception to the economic loss rule in regard to claims against attorneys, accountants, auditors, and lenders.[182] The Supreme Court of Texas, in *Grant Thornton*, held that an accountant, who provides an audit report for the guidance of investors, could be sued for negligent misrepresentation by the limited class that the report was provided by virtue of the accountant's status as a professional.[183] Similarly, in *McCamish*, the Supreme Court of Texas held that a lawyer, as a professional, is liable for negligent misrepresentation to a nonclient in narrow circumstances.[184]

The Supreme Court of Pennsylvania, in *Bilt-Rite Contractors, Inc. v. Architectural Studio*, applied the "professional malpractice" exception to the application of the economic loss rule in the construction context.[185] The Court held that "an architect, in the performance of his contract with his employer, is required to exercise the ability, skill, and care customarily used by architects upon such projects,"[186] and further explained that professional malpractice has long been recoverable in tort.[187] Similarly, the Minnesota Court of Appeals rejected the contention that a design professional owes no duty to anyone absent a contract.[188] The court recognized that the prevailing rule throughout the majority of jurisdictions is that professionals rendering services are liable in situations in which they are negligent in providing those services.[189] The court explained the reasoning behind the professional liability rule:

> Architects, doctors, engineers, attorneys, and others [i.e., other professionals] deal in somewhat inexact sciences and are continually called upon to exercise their skilled judgment in order to anticipate and provide for random factors which are incapable of precise measurement. The indeterminate nature of these factors makes it impossible for professional service people to gauge them with complete accuracy in every instance. Thus, doctors cannot promise that every operation will be successful; a lawyer can never be cer-

181. RESTATEMENT (THIRD) OF TORTS § 6, cmt. b (AM. LAW INST. 2012).
182. *LAN/STV*, 435 S.W.3d at 244–45.
183. Grant Thornton LLP v. Prospect High Income Fund, 314 S.W.3d 913, 915–17 (Tex. 2010).
184. McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787, 794–95 (Tex. 1999).
185. Bilt-Rite Contractors, Inc. v. Architectural Studio, 866 A.2d 270 (Pa. 2005).
186. *Id.* at 286–87.
187. *Id.* at 288.
188. Waldor Pump & Equip. Co. v. Orr-Schelen-Mayeron & Assocs., Inc., 386 N.W.2d 375, 376–77 (Minn. Ct. App. 1986).
189. *Id.*

> tain that a contract he drafts is without latent ambiguity; and an architect cannot be certain that a structural design will interact with natural forces as anticipated. Because of the inescapable possibility of error[,] which inheres in these services, the law has traditionally required, not perfect results, but rather the exercise of that skill and judgment which can be reasonably expected from similarly situated professionals.[190]

LAN/STV's negligence was not debated in the *LAN/STV* case, and the Court clearly stated that "professional malpractice" is an exception to the application of the economic loss rule.[191] Further, LAN/STV did not exercise the skill and judgment that can reasonably be expected from similarly situated design professionals.[192] LAN/STV provided design plans that were 80% inaccurate, whereas the industry standard for inaccuracies in design plans is 10%.[193] Accordingly, the *LAN/STV* Court should have expanded the "professional malpractice" exception to design professionals and held that design professionals are liable for negligent misrepresentation in Texas, the same way accountants and attorneys are. There is no reason why design professionals should be treated differently from other professionals with respect to negligent misrepresentation liability.[194]

E. *Special Relationship Exception to the Economic Loss Rule*

Several jurisdictions refuse to apply the economic loss rule because a "special relationship" exists between contractors and design professionals. Jurisdictions that apply the "special relationship" exception allow a contractor who suffers economic losses, which result from their justifiable reliance on inaccurate design plans, to bring a negligent misrepresentation claim against the design professional, regardless of privity.[195] For example, the Florida District Court of Appeals relied upon section 552 and held that a design professional who

190. *Id.* (citing City of Mounds View v. Walijarvi, 263 N.W.2d 420, 423 (Minn. 1978)).

191. LAN/STV v. Martin K. Eby Constr. Co., 435 S.W.3d 234, 243–44 (Tex. 2014).

192. *See id.* at 236.

193. *See* Transcript of Oral Argument, *supra* note 80. Generally, contractors expect about 10% of their designs will need adjustment; in this case 80% of the designs needed adjustment. *LAN/STV*, 435 S.W.3d at 236.

194. The Bachelor of Architecture normally requires at least five years to complete. The Master of Architecture requires from one to five years to complete depending on the individual student's previous education. When the master's degree follows a four-year, pre-professional architecture degree, it represents the "two" in the term "four-plus-two" program, and is the final portion of the professional phase of the study program. The Doctor of Architecture requires three years to complete after a pre-professional degree, the "three" in the terms "four plus three" and is the final portion of the professional phase of the study program. *Architecture Programs*, ASS'N COLLEGIATE SCH. ARCHITECTURE, http://www.acsa-arch.org/resources/student-resources/overview/architecture-programs [http://perma.cc/4VWV-D3BA].

195. Schneier, *supra* note 12, § 17 (discussing courts that refuse to apply the economic loss rule due to a special relationship between the architect and contractor).

prepares erroneous design documents with knowledge that the owner will supply them to a contractor is a sufficient basis to establish a special relationship.[196] The Florida court then applied section 552 and held that the economic loss rule does not bar an action for pure economic losses when a special relationship exists between the professional and the third-party.[197] Similarly, in *Eastern Steel Constructors, Inc. v. City of Salem*, a contractor sued a design professional for economic losses caused by the design professional's design flaws.[198] The Supreme Court of West Virginia, in *Eastern Steel Constructors, Inc.*, held that a contractor may sue the design professional for negligent misrepresentation to recover economic losses because a "special relationship" exists between the parties.[199] The Court further explained that because a "special relationship" exists between a design professional and contractor, regardless of privity, the design professional owes a duty of care to a contractor that has contracted with the same project owner and who has relied upon the design professional's plans in carrying out his or her obligations to the owner.[200] Therefore, the *LAN/STV* Court could have applied the "special relationship" exception and held that regardless of privity between LAN/STV and Eby, a "special relationship" between the two had been formed. This "special relationship" imposed a duty of care upon LAN/STV to provide accurate design plans to LAN/STV—a duty that LAN/STV breached.

VI. Policy Issues Support the Adoption of the Restatement Section 552

There are several policy and practical considerations in favor of adopting section 552 in Texas. First, limiting available damages to only those contracted for has the potential to negatively impact the motivation for design professionals to provide accurate plans, because tort liability, which provides strong incentives to not engage in negligent activity that could result in monetary damages, has been eliminated. Second, limiting the available damages to only those contracted for has the potential of negatively impacting unsophisticated parties. Third, limiting the available damages to only those contracted for will

196. Hewett-Kier Constr., Inc. v. Lemuel Ramos & Assocs., Inc., 775 So. 2d 373, 374–75 (Fla. Dist. Ct. App. 2000).

197. *Id.* at 375 (citing Restatement (Second) of Torts § 552 (Am. Law Inst. 1977)).

198. E. Steel Constructors, Inc. v. City of Salem, 549 S.E.2d 266, 268–69 (W. Va. 2001).

199. *Id.* at 277 ("[A] design professional . . . providing plans and specifications that will be followed by the contractor in carrying out some aspect of a design, impliedly warrants to the contractor, notwithstanding the absence of privity of contract between the contractor and the design professional, that such plans and specifications have been prepared with the ordinary skill, care and diligence commensurate with that rendered by members of his or her profession.").

200. *Id.*

negatively impact public-works construction projects, as the contractor does not have the same opportunity to bargain with the owner as do the parties engaged in private construction projects.

A. *Disincentive to Provide Accurate Work*

Tort liability is a powerful economic incentive for design professionals to not provide faulty or negligently misrepresented design plans to contractors.[201] However, the *LAN/STV* Court held that a design professional who provides negligently misrepresented design documents to a third-party contractor, on which he or she justifiably relies, should not be exposed to tort liability because there is no contractual relationship between the parties.[202] Eliminating the availability of damages in tort removes a powerful incentive for the design professional to ensure that they are providing accurate design plans—as they will rarely be in contractual privity with the contractor in these types of construction projects.[203] Although courts have been reluctant to impose tort liability for pure economic losses, states *have* recognized the negligent misrepresentation exception to the application of the economic loss rule, particularly where policy concerns about administrative costs and the disproportionate balance between liability and fault weigh in favor of liability.[204] Nevada has adopted this exception based on its view that without such liability, the law would not exert significant financial pressures to avoid such negligence.[205] Similarly, the First Circuit explained, "Awarding damages for financial harm caused by negligent misrepresentation is special in that, without such liability, tort law would not exert significant financial pressure to avoid negligence; [for example] a negligent accountant lacks physically harmed victims as potential plaintiffs."[206] The design professional intends and expects that the contractor on the project will use the design plans and rely on the design professional's assurance of quality. Because the design professional is inviting the use, the design professional should not be permitted to avoid responsibility when the expected use leads to injury and loss by claiming that he or she made no contact directly with the user. The design professional *has* committed a tort, and therefore *should* be liable for economic losses that stem from that tort. The economic incentive of tort liability for design professionals to not negligently misrepresent design plans should not be eliminated in the construction context where the stakes are often high and the parties are professionals. Texas should instead adopt section 552,

201. DEVLIN, *supra* note 13, at 80–86.
202. LAN/STV v. Martin K. Eby Constr. Co., 435 S.W.3d 234, 249–50 (Tex. 2014).
203. DEVLIN, *supra* note 13, at 80–86.
204. Terracon Consultants W., Inc. v. Mandalay Resort Grp., 206 P.3d 81, 88 (Nev. 2009).
205. *Id.* at 88–89.
206. *See*, *e.g.*, Barber Lines A/S v. M/V Donau Maru, 764 F.2d 50, 56 (1st Cir. 1985).

which maintains tort liability and the economic incentive to provide quality work.

B. *Unsophisticated Parties Are Prejudiced by the* LAN/STV *Decision*

The influence of the *LAN/STV* decision on unsophisticated parties is concerning. The Court in *LAN/STV* brushed past the effects that the contract-only remedy could have on unsophisticated parties. Specifically, the Court held that it was more probable than not that a contractor *would assume* that it must look to its agreement with the owner for damages if the project is not as represented.[207] Although sophisticated parties understand that they are free to assign risk by contract through negotiation, which the law does not allow in tort, unsophisticated parties can be jeopardized by the assignment of risk through the contract-only approach.[208] The contract-only approach disallows tort claims between parties indirectly linked by contract, asserting pressures on the parties to specify rights, obligations, and remedies carefully in advance.[209] Although sophisticated parties may understand the necessity of specifying rights and remedies in advance to protect their interests, unsophisticated parties are more likely to be confused by the broad tort rule and fail to contract for the protection they need, inadvertently resulting in a lack of remedy for an injured party.[210] Even sophisticated parties are confused by this rule—take the *LAN/STV* case for example. Section 552 is concerned with the well-being of unsophisticated parties who may not know or understand the necessity of negotiating for rights and remedies through contract in advance.[211] Section 552 protects unsophisticated parties who

207. *LAN/STV*, 435 S.W.3d at 247–48 (emphasis added).

208. RESTATEMENT (THIRD) OF TORTS § 3, cmt. f (AM. LAW INST., Tentative Draft, No. 2, 2014). The Restatement posits the following situation in illustration 8 to section 3:

> City hires Engineer to test soil conditions at a site where it plans to erect a large building. City explains that Engineer's report will be distributed to prospective building contractors for use in estimating their costs. Engineer negligently submits an inaccurate report. Contractor wins the right to perform the construction, having relied on Engineer's report in preparing its bid. Engineer's errors cause Contractor to suffer losses in performing its contract with City. The contracts between Contractor and City, and between City and Engineer, do not preclude a claim by Contractor against Engineer [for negligent performance of services or negligent misrepresentation]. Engineer remains potentially liable to Contractor under either of those [torts]. But the Restatement adds: Contractor could have insisted that City guarantee the soundness of Engineer's report, and City could have insisted that Engineer indemnify City for claims brought against it by Contractor. In effect, those contracts would have protected Contractor against the risk of errors by Engineer, and would have ensured that Engineer would bear the costs of its negligence.

209. *Id.* § 3 (citing reporter's note to cmt. f).

210. *Id.*

211. *See generally* RESTATEMENT (SECOND) OF TORTS § 552 (1977).

may lack this foresight by providing an equitable remedy for claims of negligent misrepresentation through tort.[212] Why should Texas law leave an injured party without remedy, when a remedy in tort is so readily available? Some courts have even asked the question, why should a party *fortunate* enough to not have suffered personal injuries not have a remedy in tort—economic losses are important too![213]

C. *Public-Works Projects Have Little Opportunity for Bargaining*

One principle underlying the decision in *LAN/STV* to apply the economic loss rule is that the parties are in the best position to protect their interests through bargaining and contractual negotiation.[214] However, the *LAN/STV* Court did not consider the effect the holding would have in the realm of public contracting, where such opportunity for bargaining does not exist. Construction projects for public works oftentimes must be awarded to the lowest responsible bidder, and the contractual language, which is distributed with the invitation for bid, is not subject to traditional negotiation as is present in private contracts.[215] In fact, contractors typically must all bid upon the same fixed terms provided by the public entity.[216] If the public entity does not provide a provision in the contract protecting the contractor from responsibility for defective plans and specifications, then the risk and liability resulting from defective design documents rests upon the contractor under Texas common law.[217] Under the *LAN/STV* rule, public contractors will continue to bear a disproportionate amount of risk for defects over which they have no legitimate opportunity to control through contractual bargaining and negotiation.

VII. Conclusion

Section 552 of the Restatement (Second) of Torts is not radical or revolutionary, it merely reflects the modern realities of business relationships—parties must rely on the specialized expertise of those with whom they have no contractual relationship. The *LAN/STV* Court had an opportunity to adopt section 552 and hold design professionals responsible in tort for the negligent designs they provide, which several American jurisdictions have already adopted. Following the *LAN/STV* decision, Texas law is "settled" in regard to the applicabil-

212. *See id.*; Restatement (Third) of Torts § 3 (Am. Law Inst., Tentative Draft No. 1, 2012).

213. *See* Morrow v. New Moon Homes, Inc. 548 P.2d 279, 291 (Alaska 1976).

214. LAN/STV v. Martin K. Eby Constr. Co., 435 S.W.3d 234, 246 (Tex. 2014).

215. *See generally* Tex. Loc. Gov't Code § 252.043 (West 2012).

216. *Id.*

217. Lonergan v. San Antonio Loan & Trust Co., 104 S.W. 1061, 1068 (Tex. 1907) (establishing the common law rule for risk and liability resulting from design documents in public works contracts).

ity of the economic loss rule in the construction context, but it is far from equitable.

Texas should instead adopt the negligent misrepresentation exception, set forth in section 552 of the Restatement (Second) of Torts, to the application of the economic loss rule in the construction context because it provides balanced and equitable results. Design professionals are *professionals* who should be held to a standard common law duty of care. Texas has already adopted the negligent misrepresentation exception to other categories of professionals, and there is no clear reason why the exception should not also extend to design professionals. Section 552 limits the class of individuals the design professional will be liable to, eliminating any fear of unlimited liability to an indeterminate class, and most importantly holds the professional responsible when the work he or she provides is negligent. Future court decisions will hopefully recognize the inequities of this rule in such a way that the court will have no choice but to allow recovery of economic damages in tort. But until then, contractors will have to rely on their existing contract with the project owner to recover their economic losses.