SHARYLAND WATER

ECONOMIC LOSS RULE-
WHAT QUESTIONS ANSWERED?

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SHARYLAND WATER SUPPLY

- Sharyland Water Supply Corporation v. City of Alton, Carter & Burgess, Inc., Cris Equipment Company, And Turner, Collie & Braden, Inc.
- Decided October 21, 2011
- Several Issues Before The Court Including Governmental Immunity, Chapter 33, Joint and Several, and Interpretation of 30 TAC 317.13

SHARYLAND WATER SUPPLY

- Most anticipated issue was the interpretation of the Economic Loss Rule

FACTS

- Early 1980's-Alton constructed a potable water distribution system for residents
- Water supply agreement -- Alton conveyed water distribution system to Sharyland which would maintain system and provide water to residents
- 1994 -- Alton received grant for construction of sanitary sewer

FACTS

- Alton contracted with Carter & Burgess; Turner, Collie & Braden and Cris Equipment to build a sanitary sewer system
- 1999 -- Construction completed
- 2000 -- Sharyland sues claiming sewer lines installed in violation of state regulations with respect to proximity and location of sewer lines to water lines

TRIAL COURT

- Jury found Alton breached agreement and that three contractors breached their contracts and Sharyland was a third-party beneficiary
- Jury awarded identical damages for each of three claims: $14,000 in past damages and $1,125,000 in future damages

COURT OF APPEALS

- Court of appeals held Alton waived immunity but that damages were not for "balance due and owed" local gov't code 271.153) and Sharyland could only recover attorneys' fees for declaratory judgment action (re application of 30 TAC 317.13) against Alton

COURT OF APPEALS

- Court of appeals concluded that economic loss rule barred Sharyland's negligence claims and that Sharyland was not a third-party beneficiary for the contractors' breach

SUPREME COURT

- CITY OF ALTON-LOCAL GOV'T CODE 271.153(a)
- (1) the balance due and owed by the local governmental entity under the contract as it may have been amended, including any amount owed as compensation for the increased cost to perform the work as a direct result of owner-caused delays or acceleration;
- (2) the amount owed for change orders or additional work the contractor is directed to perform by a local governmental entity in connection with the contract; and
- (3) interest as allowed by law.

CITY OF ALTON

- Section 271.153(b) further limits damages by excluding the following forms of recovery under subchapter I:
- (1) consequential damages, except as expressly allowed under Subsection (a)(1);
- (2) exemplary damages; or
- (3) damages for unabsorbed home office overhead.

CITY OF ALTON

- "The kind of damages sought by Sharyland were not those provided for or contemplated in the water supply agreement and are not a 'balance due and owed' under that contract. Nor are these costs the 'direct result of owner-caused delays or acceleration,' or the 'amount owed for change orders or additional work the contractor [was] directed to perform by [the] governmental entity in connection with the contract.' . . . A plain reading of the statute negates recovery under this chapter."

CITY OF ALTON

- Waiver of immunity by counterclaim not applicable since Alton's counterclaim was dismissed via summary judgment.
- Equitable waiver -- "We reject the invitation to recognize a waiver-by-conduct exception in a breach-of-contract against a governmental entity."

CONTRACTORS

- DIFFICULTY IN DEFINING:
- "[T]here is not one economic loss rule broadly applicable throughout the field of torts, but rather several more limited rules that govern recovery of economic losses in selected areas of the law. For example, the rules that limit the liability of accountants to third parties for harm caused by negligence or that save careless drivers from liability to the employer of a person injured in an auto accident may be fundamentally distinct from the ones that bar compensation in tort for purely economic losses resulting from defective products or misperformance of obligations arising only under contract."

ECONOMIC LOSS RULE

- *Seely* is considered a seminal case on the economic loss rule. The *Seely* court explained that:
- A consumer should not be charged at the will of the manufacturer with bearing the risk of physical injury when he buys a product on the market. He can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will. Even in actions for negligence, a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone.
- *Seely v. White Motor Co.*, 403 P.2d 145, 151 (Cal. 1965).

ECONOMIC LOSS RULE

- "Our earliest articulation of the economic loss rule came in a product liability case. *See Nobility Homes of Tex., Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977). In *Nobility Homes*, a mobile home purchaser sued the manufacturer for defective workmanship and materials. *Id.* at 77-78. We held that the plaintiff could 'not recover his economic loss under section 402A of the Restatement (Second) of Torts,'9 establishing strict liability for defective products, but that he could 'recover such loss under the implied warranties of the Uniform Commercial Code.' *Id.* at 78. Importantly, we did not hold that economic damages were unavailable, but rather that they were more appropriately recovered through the UCC's thorough commercial-warranty framework."

ECONOMIC LOSS RULE

- "We reprised this theme six years later in *Mid Continent Aircraft Corp. v. Curry County Spraying Service, Inc.*, 572 S.W.2d 308, 312-13 (Tex. 1978). Curry bought an overhauled aircraft from Mid Continent and sued after the plane crashed. *Id.* at 309-10. We rejected a strict product liability theory in favor of an implied warranty action under the UCC, because Curry's economic loss (damage to the plane itself) was 'merely loss of value resulting from a failure of the product to perform according to the contractual bargain and therefore is governed by the Uniform Commercial Code.' *Id.* at 311. We distinguished cases involving personal injury or damage to property other than the product itself, noting that those damages could be recovered under strict liability theories. *Id.* at 311-13."

ECONOMIC LOSS RULE

- "Subsequently, in *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986), we examined the difference between contract duties and tort duties arising under contractual relationships. That case involved a claim by homeowners against their builder, and we had to decide whether an independent tort supported an award of exemplary damages against the builder. *Jim Walter Homes*, 711 S.W.2d at 617. Because the injury resulted from negligent construction, we held that such disappointed expectations could 'only be characterized as a breach of contract, and breach of contract cannot support recovery of exemplary damages.' *Id*. at 618."

ECONOMIC LOSS RULE

- "[W]e again applied the economic loss rule in *Southwestern Bell Telephone Co. v. Delanney*, 809 S.W.2d 493 (Tex. 1991). In that case, we considered 'whether a cause of action for negligence is stated by an allegation that a telephone company negligently failed to perform its contract to publish a Yellow Pages advertisement.' *Delanney*, 809 S.W.2d at 493. We held that, because the plaintiff sought damages for breach of a duty created under contract, as opposed to a duty imposed by law, tort damages were unavailable. *Id.* at 494."

ECONOMIC LOSS RULE

- Quoting *Jim Walter Homes*, we explained that [t]he acts of a party may breach duties in tort or contract alone or simultaneously in both. The nature of the injury most often determines which duty or duties are breached. When the injury is only the economic loss to the subject of a contract itself the action sounds in contract alone.

ECONOMIC LOSS RULE

- "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),13 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."

ECONOMIC LOSS RULE

- "The court of appeals relied on a different sort of economic loss rule—one that says that you can never recover economic damages for a tort claim—to reject Sharyland's negligence claim against the contractors. That court analyzed whether Sharyland's claim was one for property damage or for purely economic loss and concluded it was the latter. 277 S.W.3d at 154-55 noting that 'some physical destruction of tangible property must occur' for there to be property damage). Because there was no evidence that the sewer lines had contaminated the water supply, the court of appeals reasoned, Sharyland had not suffered property damage, and the economic loss rule precluded a damage award. *Id.*"

ECONOMIC LOSS RULE

- "There are at least two problems with this analysis. First, it both overstates and oversimplifies the economic loss rule. *See, e.g.*, *Giles v. GMAC*, 494 F.3d 865, 874 (9th Cir. 2007) (noting that "many courts have stated in overly broad terms that purely economic losses cannot be recovered in tort" but "[s]uch broad statements are not accurate"). To say that the economic loss rule "preclude[s] tort claims between parties who are not in contractual privity" and that damages are recoverable only if they are accompanied by "actual physical injury or property damage," 277 S.W.3d at 152-53, overlooks all of the tort claims for which courts have allowed recovery of economic damages even absent physical injury or property damage."

ECONOMIC LOSS RULE

- "Moreover, the question is not whether the economic loss rule should apply where there is no privity of contract (we have already held that it can), but whether it should apply at all in a situation like this. 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 rule does not swallow all claims between contractual and commercial strangers."

ECONOMIC LOSS RULE

- "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. *See, e.g.*, Johnson, 66 WASH.&LEE L.REV. at 527 (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')."

ECONOMIC LOSS RULE

- "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."

ECONOMIC LOSS RULE

- "These expenses, imposed on Sharyland by the contractors' conduct, were the damages the jury awarded. Costs of repair necessarily imply that the system was damaged, and that was the case here. Sharyland presented evidence that it experiences between 100 and 150 water system leaks each year. A break in the water line threatens contamination. There was evidence that when Sharyland excavated a representative sample of sixty-six sewer crossings, sixty of them had been illegally installed, and there was at least one leaking sewer pipe located six inches above a water pipe. There was also evidence that approximately 340 locations would require remediation. We disagree that the economic loss rule bars Sharyland's recovery in this case."

THIRD PARTY BENEFICIARY

- "Sharyland argues that there was evidence to support the jury finding that Sharyland was a third party beneficiary of the agreements between Alton and the contractors. The court of appeals disagreed, holding that Sharyland was 'no more than an incidental beneficiary' to the contract. 277 S.W.3d at 152. 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."

CONCLUSION

- HOLDINGS:
  - 1) economic damages may be recovered in tort cases
  - 2) economic damages not prohibited where the issue is the subject of a contract
  - 3) economic damages may be recovered where there is property damage
  - 4) left open whether purely economic damages may be recovered in negligence or strict liability cases

THE END