HAVING YOUR CAKE AND EATING IT TOO: POST-CONTRACT-FORMATION FRAUD

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I. INTRODUCTION

The economic-loss rule generally prevents a party suing for breach of contract from recovering in tort absent an injury or a breached duty not contemplated in the contract—thus barring an opportunity for punitive or exemplary damages.[1] The economic-loss rule seeks to preserve parties' freedom to contract while limiting the courts' ability to reform the contract to give the injured party a benefit for which it never bargained.[2] However, the Texas Supreme Court fashioned an exception to the economic-loss rule in a narrow intersection of tort and contract.[3]

In *Presidio*, the Texas Supreme Court created an exception to the economic-loss rule that enabled injured parties to recover in tort when they were fraudulently induced (i.e., pre-contract-formation fraud) to enter into a contract.[4] This exception was largely based on the public policy concern of deterring intentional torts like fraud.[5] Even though this was in tension with

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[1] LAN/STV v. Martin K. Eby Const. Co., 435 S.W.3d 234, 242 n.35 (Tex. 2014) ("This Court has held in Jim Walter Homes, Inc. v. Reed: 'When the injury is only the economic loss to the subject of a contract itself, the action sounds in contract alone.' 711 S.W.2d 617, 618 (Tex.1986). *See also* Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 494 (Tex.1991) ('When the only loss or damage is to the subject matter of the contract, the plaintiff's action is ordinarily on the contract.'). We have repeatedly reaffirmed this rule").

[2] *See* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 872–73 (1986); Jim Wren, *Applying the Economic Loss Rule in Texas*, 64 BAYLOR L. REV. 204, 215 (2012).

[3] Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 46–47 (Tex. 1998).

[4] *See id.*

[5] *See id.* at 47 (citing Graham v. Roder, 5 Tex. 141, 149 (1849)); *see, e.g.*, Spoljaric v. Percival Tours, Inc., 708 S.W.2d 432, 436 (Tex. 1986); Int'l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 583 (Tex. 1963). *Cf.* TEX. CIV. PRAC. & REM. CODE § 41.003(a)(1) (expressly

the mere economic-loss rule, the Court chose not to leave such fraudulent behavior unpunished.[6]

Today, Texas intermediate appellate courts are split as to whether to extend *Presidio*'s exception to the economic-loss rule to post-contract-formation fraud claims.[7] Resolution of this split is significant because it will dictate whether punitive damages are available for post-contract-formation fraud claims.[8] Since the elements of fraud are much more difficult to prove than those of breach of contract, the only reason plaintiffs would be expected to pursue post-contract-formation fraud would be for the possibility of punitive damages. But allowing punitive damages implicates the concern that excessive damage awards undermine parties' contractual allocation of their risks and drastically raise transaction costs.[9]

This Comment recommends a solution to this court split that favors reconciling competing policy interests *against* recovery in tort when fraud occurs post-contract formation.[10]

In Part I, this Comment will introduce the Texas courts' historical application of the economic-loss rule and how *Presidio* fashioned an exception in the context of fraudulent inducement of a contract.[11] Then, this Comment will distinguish between pre-contract-formation and post-contract-formation fraud—focusing on the consequences of the distinction.[12] Part II shows the split between Texas intermediate appellate courts on whether to extend *Presidio*'s exception to the economic-loss rule to post-contract-formation fraud.[13] Part III explains the competing policy interests: deterring fraud and preventing erosion of the economic-loss rule, which entails protecting parties' freedom to contract as well as minimizing societal transaction costs.[14] This section balances these competing policy interests *against* recovery in tort when fraud occurs post-contract formation.

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authorizing exemplary damages for fraud without making any exception based on the type of loss sustained by the injured party).

[6] *See id.*

[7] *See* discussion *infra* Parts II.A–B.

[8] *See* discussion *infra* Parts II.A–B.

[9] Desnick v. Am. Broad. Cos., 44 F.3d 1345, 1354 (7th Cir. 1995).

[10] Budgetel Inns, Inc. v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1147 (E.D. Wis. 1998) ("The most obvious way to distinguish an independent tort from a breach of contract is by determining when the alleged independent tort took place.").

[11] *See* discussion *infra* Parts I.A–B.

[12] *See* discussion *infra* Part I.C.

[13] *See* discussion *infra* Parts II.A–B.

[14] *See* discussion *infra* Part III.A–B.

Finally, Part IV discusses the possibilities for tort recovery on post-contract-formation actions where such actions exceed the scope of the preexisting contractual relationship.

A. Economic-Loss Rule

Traditionally, the economic-loss rule has been applied as a bar to recovering purely economic losses (*i.e.*, pecuniary or monetary losses) in tort without actually having suffered a physical injury or property damage.[15] The economic-loss rule is better thought of as a series of rules that govern economic losses covering a wide range of tort-based issues like products liability and negligent misrepresentation—with different formulations for each subject.[16] With respect to contract law, the economic-loss rule generally precludes recovery in tort for economic losses resulting from the failure of a defendant to perform under its contract with a plaintiff.[17] Thus, the rule restricts parties to their contractually bargained-for remedies.[18] This Comment focuses on where the tort of fraud occurs in the midst of a contractual relationship and the damages suffered are those contemplated by the contract—colloquially called the field of "contorts."

Contorts is a moniker for alleged torts that arise out of contractual relationships.[19] Professor Prosser once stated: "The borderland of tort and contract, and the nature and limitations of the tort action arising out of a

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[15] Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 415, 418 (Tex. 2011) ("'The most general statement of the economic loss rule is that a person who suffers only pecuniary loss through the failure of another person to exercise reasonable care has no tort cause of action against that person.'" (quoting Jay M. Feinman, *The Economic Loss Rule and Private Ordering*, 48 ARIZ. L. REV. 813, 813 (2006)) (footnote omitted)) ("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."); *see also* Wren, *supra* note 2, at 209 nn.29–30.

[16] *Sharyland*, 354 S.W.3d at 415 ("'[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.'" (quoting Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 534–35 (2009))).

[17] Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 12 (Tex. 2007).

[18] *See id.* at 12–13 (citing Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986)).

[19] Cass v. Stephens, 156 S.W.3d 38, 68 (Tex. App.—El Paso 2004, pet. denied) ("The law of 'contorts' is a muddy area, devoid of bright line rules or easy answers as to what conduct constitutes a tort, and what a breach of contract.").

breach of contract, are poorly defined."[20] The economic-loss rule limits the contracting parties to the contractual remedies for economic losses, regardless of how the breaching party committed the breach.[21] For example, if a homebuyer sues because the house it received was not the house it was allegedly promised, such an injury can only be characterized as a breach of contract.[22] Whether the breach was negligent or intentional is immaterial according to the economic-loss rule.[23] Accordingly, exemplary damages are unavailable for the breach of the contract.[24]

Nevertheless, the Texas Supreme Court has recognized that parties to a contract may breach duties in tort, contract, or *both*.[25] With respect to contorts, Texas recognizes two tests to determine whether the economic-loss rule bars recovery in tort in the midst of a contractual relationship.[26] First, the "nature of the injury" or "independent injury" test: "When the injury is only the economic loss to the subject of a contract itself [i.e., the benefit of the bargain], the action sounds in contract alone."[27] If the

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[20] WILLIAM LLOYD PROSSER, SELECTED TOPICS ON THE LAW OF TORTS 452 (1953); *see also* Sw. Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 495 n.2 (Tex. 1991) ("Prosser and Keeton suggest seven generalizations as helpful in distinguishing between tort and contract liability. Those which are useful to this case include: (1) obligations imposed by law are tort obligations; (2) misfeasance or negligent affirmative conduct in the performance of a promise generally subjects an actor to tort liability as well as contract liability for physical harm to persons and tangible things; (3) recovery of intangible economic losses is normally determined by contract law; and (4) there is no tort liability for nonfeasance, i.e., for failing to do what one has promised to do in the absence of a duty to act apart from the promise made.").

[21] LAN/STV v. Martin K. Eby Const. Co., 435 S.W.3d 234, 242 n.35 (Tex. 2014) (citing *Lamar Homes, Inc.*, 242 S.W.3d at 12 (Tex. 2007)); *see also Jim Walter Homes, Inc.*, 711 S.W.2d at 618 (citing Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 571 (Tex. 1981)); City Prods. Corp. v. Berman, 610 S.W.2d 446, 450 (Tex. 1980)).

[22] *Jim Walter Homes, Inc.*, 711 S.W.2d at 618.

[23] *Id.* (citing *Amoco Prod. Co.*, 622 S.W.2d at 571); *City Prods. Corp.*, 610 S.W.2d at 450 ("Gross negligence in the breach of contract will not entitle an injured party to exemplary damages because even an intentional breach will not.").

[24] *Jim Walter Homes, Inc.*, 711 S.W.2d at 618 (citing *Amoco Prod. Co.*, 622 S.W.2d at 571); *City Prods. Corp.*, 610 S.W.2d at 450.

[25] *Jim Walter Homes, Inc.*, 711 S.W.2d at 618; Montgomery Ward & Co. v. Scharrenbeck, 204 S.W.2d 508, 510–11 (Tex. 1947); *see DeLanney*, 809 S.W.2d at 494 n.1 ("Of course, some contracts involve special relationships that may give rise to duties enforceable as torts, such as professional malpractice.").

[26] *See DeLanney*, 809 S.W.2d at 494–95.

[27] *Jim Walter Homes, Inc.*, 711 S.W.2d at 618; *see also DeLanney*, 809 S.W.2d at 494–95; Mickens v. Longhorn DFW Moving, Inc., 264 S.W.3d 875, 879 (Tex. App.—Dallas 2008, pet. denied).

breaching party's acts dealt with the subject of the contract, the plaintiff could only recover on the contract, not in tort.[28]

Second, the "independent duty" test: whether the breaching party breached an independent duty arising out of the law outside the terms of the contract.[29] If the breached duty was imposed by the contract, the plaintiff's claim sounds only in breach of contract.[30] This test stems from the belief that "[t]ort obligations are in general obligations that are imposed by law—apart from and independent of promises made and therefore apart from the manifested intention of the parties—to avoid injury to others."[31]

In *Southwestern Bell Telephone v. DeLanney*, the Texas Supreme Court applied both the independent injury and independent duty tests.[32] But even after *DeLanney*, Texas courts have been uncertain as to how to apply the tests, especially to fraud causes of action.[33] More specifically, it remains uncertain whether *DeLanney* requires both tests to be satisfied to avoid application of the economic-loss rule in instances of fraud related to a contract.[34]

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[28] *See DeLanney*, 809 S.W.2d at 494.

[29] *See id.* (citing W. KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 92, at 655 (5th ed. 1984)).

[30] *See Jim Walter Homes, Inc.*, 711 S.W.2d at 618.

[31] *See id.*

[32] *See id.*

[33] *See* Wren, *supra* note 2, at 240 ("The Texas Supreme Court has never explicitly clarified how the two [*Delanny* tests] . . . are to be balanced against each other . . . ."); *see, e.g.*, Tarrant Cnty. Hosp. Dist. v. GE Automation Serv., 156 S.W.3d 885, 895 (Tex. App.—Fort Worth 2005, no pet.) (only using the independent-injury test); Hooker v. Nguyen, No. 14-04-00238-CV, 2005 WL 2675018, at *4 (Tex. App.—Houston [14th Dist.] Oct. 20, 2005, pet. denied) (mem. op.) (looking first at independent-injury test, then looking to independent duty test); UMLIC VP LLC v. T & M Sales & Envtl. Sys., Inc., 176 S.W.3d 595, 613–15 (Tex. App.—Corpus Christi 2005, pet. denied) (applying both tests and weighing them against each other).

[34] *See, e.g.*, Regus Mgmt. Grp., LLC, v. Int'l Bus. Mach. Corp., No. 3:07-CV-1799-B, 2008 WL 1836360, at *6 (N.D. Tex. Apr. 24, 2008) ("In determining whether a claim can be brought as a tort, consideration must be given to (1) 'the source of the defendant's duty to act (whether it arose solely out of the contract or from some common-law duty) and (2) the nature of the remedy sought by the plaintiff.' If the defendant's duty arose independently of the fact that a contract exists between the parties, the plaintiff's claim is more likely to sound in tort. However, if the remedy sought by the plaintiff is only the loss or damage to the subject matter of the contract, the plaintiff's action is ordinarily on the contract." (quoting Crawford v. Ace Sign, Inc., 917 S.W.2d 12, 13 (Tex. 1996); *DeLanney*, 809 S.W.2d at 494–95)).

B. Fraudulent Inducement

Fraudulent inducement "is a particular species of fraud that arises only in the context of a contract and requires the existence of a contract as part of its proof."[35] Accordingly, "the elements of fraud must be established as they relate to an agreement between the parties."[36]Texas law has long imposed a duty to abstain from inducing another to enter into a contract through the use of fraudulent misrepresentations.[37] Consequently, a party is not bound by a contract induced by fraud.[38] Additionally, the duty not to fraudulently induce a contract is separate and independent from the duties established by the contract itself.[39]

In *Presidio*, the Texas Supreme Court held that fraudulent-inducement claims were not fully subject to the economic-loss rule, but it did not explicitly address other species of fraud (e.g., post-contract-formation fraud) even though its general commentary was couched in terms of fraud.[40] The Court *suspended* the independent-injury requirement under *DeLanney* for fraudulent-inducement claims where damages sought were based on the

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[35] Haase v. Glazner, 62 S.W.3d 795, 798 (Tex. 2001); *see also* Clark v. Power Mktg. Direct, Inc., 192 S.W.3d 796, 799 (Tex. App.—Houston [1st Dist.] 2006, no pet.); Coastal Bank SSB v. Chase Bank of Tex., 135 S.W.3d 840, 843 (Tex. App.—Houston [1st Dist.] 2004, no pet.).

[36] *Haase*, 62 S.W.3d at 798–99 (Tex. 2001); *see* Kajima Int'l, Inc. v. Formosa Plastics Corp. USA, 15 S.W.3d 289, 292 (Tex. App.—Corpus Christi 2000, pet. denied) (citing DeSantis v. Wackenhut Corp., 793 S.W.2d 670, 688 (Tex.1990)) ("The elements of fraud are: (1) a material misrepresentation was made; (2) it was false; (3) when the representation was made, the speaker knew it was false or the statement was recklessly asserted without any knowledge of its truth; (4) the speaker made the false representation with the intent that it be acted on by the other party; (5) the other party acted in reliance on the misrepresentation; and (6) the party suffered injury as a result.").

[37] Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 46 (Tex. 1998).

[38] *See, e.g.*, *Presidio*, 960 S.W.2d at 46; Prudential Ins. Co. v. Jefferson Assocs., 896 S.W.2d 156, 162 (Tex. 1995); Weitzel v. Barnes, 691 S.W.2d 598, 601 (Tex. 1985); Town N. Nat'l Bank v. Broaddus, 569 S.W.2d 489, 491 (Tex.1978); Dall. Farm Mach. Co. v. Reaves, 307 S.W.2d 233, 239 (Tex. 1957).

[39] *See Presidio*, 960 S.W.2d at 46; *Dall. Farm Mach.*, 307 S.W.2d at 239 ("'[T]he law long ago abandoned the position that a contract must be held sacred regardless of the fraud of one of the parties in procuring it.'" (quoting Bates v. Southgate, 31 N.E.2d 551, 558 (Mass. 1941))).

[40] *See Haase*, 62 S.W.3d at 798 ("Some of our language in that opinion suggests that there is no distinction between a claim for fraud and one for fraudulent inducement."); Regus Mgmt. Grp., LLC, v. Int'l Bus. Mach. Corp., No. 3:07-CV-1799-B, 2008 WL 1836360, at*7 (N.D. Tex. Apr. 24, 2008) ("Although the Texas Supreme Court has not spoken directly on the tort of fraud, its commentary in [*Presidio*]—a fraudulent inducement case—is couched in terms of fraud.").

contract (i.e., the benefit of the bargain).[41] It further held that there was an independent duty at law, independent from the contract, not to fraudulently induce a party into a contract.[42]

The Court's holding was significant because it carved out an exception to the mere economic-loss rule's bar of recovering tort damages on the contract when the injured party sought damages based on the contract (i.e., the benefit of the bargain).[43] The underlying rationale was to punish fraudulent behavior, which opened the door to exemplary damages since recovery was based in tort.[44] However, this was in tension with the mere economic-loss rule, which preserves the parties' freedom to contract and limits the state's ability to reform the contract to give the injured party a benefit for which it never bargained.[45] Nevertheless, the Court could not leave such fraudulent behavior unpunished like in some states.[46]

Accordingly, the Court balanced deterring fraudulent behavior against protecting the economic-loss rule in favor of an exception to the economic-loss rule's bar to tort-based recovery when only damages on the contract were sought.[47] In other words, the *Presidio* Court suspended the independent-injury test in fraudulent inducement situations because such conduct occurred before contract formation.[48] Furthermore, it held that the independent duty test was met because the duty not to fraudulently induce a contract exists at law, separate from any contract.[49] But the Texas Supreme

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[41] *Presidio*, 960 S.W.2d at 47.

[42] *See id.*

[43] *See* Wren, *supra* note 2, at 249.

[44] *See Presidio*, 960 S.W.2d at 46–47.

[45] *See* Wren, *supra* note 2, at 249.

[46] R. Joseph Barton, *Drowning in A Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 WM. & MARY L. REV. 1789, 1811 (2000) ("A handful of courts have construed the economic loss rule to prohibit the recovery of purely economic losses in fraud. These courts conclude that because the economic loss rule bars recovery in tort, and because fraud is a tort, recovery of purely economic loss is therefore barred."). Furthermore, completely disallowing fraudulent-inducement claims would raise transaction costs because "then prospective parties to contracts will be able to obtain legal protection against fraud only by insisting that the other party to the contract reduce all representations to writing, and so there will be additional contractual negotiations, contracts will be longer, and, in short, transaction costs will be higher. And the additional costs will be incurred in the making of every commercial contract, not just the tiny fraction that end up in litigation." All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 867 (7th Cir. 1999).

[47] *Presidio*, 960 S.W.2d at 46–47.

[48] *See id.*

[49] *See id.*

Court left open the present question: whether tort recovery is allowed for post-contract-formation fraud. Consequently, the Texas intermediate appellate courts have developed a split.[50]

C. *Pre-contract-Formation Fraud Versus Post-contract-Formation Fraud*

Presidio and other fraudulent inducement cases illustrate fraud that occurs prior to contract formation.[51] Contract formation occurs when "there is a manifestation of mutual assent to the exchange and a consideration."[52] In other words, contract formation occurs when both parties agree to exchange promises to perform or to exchange performances.[53] Therefore, pre-contract-formation fraud is *synonymous* with fraudulent inducement. This is because fraudulent inducement involves fraudulent misrepresentations that induce one of the parties into assenting to the contract and exchanging consideration.[54]

On the other hand, post-contract-formation fraud involves fraudulent misrepresentations made after contract formation has already occurred.[55] For example, when a contractor sues the buyer on a commercial construction contract for fraud on performance (i.e., failure to make contract payments), that suit involves fraud in the performance of an ongoing contractual relationship, not fraud to enter into a contractual

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[50] *See* discussion *infra* Parts II.A–B.

[51] *See* discussion *infra* Parts II.A–B; 48 AM. JUR. 3D *Proof of Facts* § 1 (1998)

> ("Where a party's conduct after the inception of a contract constitutes both a breach of contract and also fraudulent, the law ordinarily requires the injured party to limit its claims to breach of contract claims and does not permit tort claims of fraud to be added on to the breach of contract claims.");

see Hooker v. Nguyen, No. 14-04-00238-CV, 2005 WL 2675018, at *6–7 (Tex. App.—Houston [14th Dist.] Oct. 20, 2005, pet. denied) (mem. op.) ("For [*Presidio*] to preclude application of the *DeLanney* [independent injury] test, however, a claim must be one of fraudulent inducement and not of mere common-law fraud . . . . we decline to extend [*Presidio*] to include fraud that allegedly occurs after the formation of a contract and that results only in loss to the subject of the contract.").

[52] RESTATEMENT (SECOND) OF CONTRACTS § 17 (1981) (objective theory of contracts); *see also* Angelou v. Afr. Overseas Union, 33 S.W.3d 269, 278 (Tex. App.—Houston [14th Dist.] 2000, no pet.) (defining the elements of a contract in Texas).

[53] *See* RESTATEMENT (SECOND) OF CONTRACTS § 3 (1981).

[54] *See Presidio*, 960 S.W.2d at 46.

[55] *See, e.g.*, *Hooker*, 2005 WL 2675018, at *6–7.

relationship.[56] Therefore, the contractor will only be able to recover contract-based, not tort-based damages.[57] Thus, post-contract-formation fraud deals with fraud committed in the performance of the preexisting contract.

In Texas, successful plaintiffs under a claim for fraudulent inducement (*i.e.*, pre-contract-formation fraud) may recover not only the economic loss of the contract (*i.e.*, the benefit of the bargain) but also punitive or exemplary damages.[58] The *Presidio* Court explained why it allowed tort-based recovery (*i.e.*, exemplary damages) for fraudulent inducement plaintiffs *in addition to* the benefit of the bargain recovery: "Since *Graham*, this Court has continued to recognize the propriety of fraud claims sounding in tort despite the fact that the aggrieved party's losses were only economic losses."[59] The Court further explained that exemplary damages were appropriate for fraudulent-inducement claims since it had already recognized such damages for tortious-interference-with-contract claims.[60] Since Texas law establishes that the benefit-of-the-bargain recovery is available under tort law, it follows that Texas law affirms the possibility that fraudulent-inducement claims may be used as a vehicle to recovering punitive damages.

Consequently, if the Texas Supreme Court excuses post-contract-formation fraud from the economic-loss rule, exemplary damages would be widely available (and used) for injured parties in breach of contract disputes.[61] The threat of exemplary damages is the real crux of this Comment. Since the elements of fraud are much more difficult to prove than those of breach of contract, it appears the only reason plaintiffs would pursue post-contract-formation fraud would be for the possibility of a

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[56] *See, e.g., id.*

[57] *See, e.g, id*. at 6–8.

[58] 48 AM. JUR. 3D *Proof of Facts* §1 (1998); *see generally* Haase v. Glazner, 62 S.W.3d 795 (Tex. 2001).

[59] *Presidio*, 960 S.W.2d at 47 (quoting Graham v. Roder, 5 Tex. 141, 149 (1849)); *see, e.g.*, Spoljaric v. Percival Tours, Inc., 708 S.W.2d 432, 436 (Tex. 1986); Int'l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 583 (Tex. 1963); *cf.* TEX. CIV. PRAC. & REM. CODE § 41.003(a)(1) (expressly authorizing exemplary damages for fraud without making any exception based on the type of loss sustained by the injured party).

[60] *Presidio*, 960 S.W.2d at 47 (citing Am. Nat'l Petroleum Co. v. Transcon. Gas Pipe Line Corp., 798 S.W.2d 274, 278 (Tex.1990)) ("Moreover, we have held in a similar context that tort damages were not precluded for a tortious interference with contract claim, notwithstanding the fact that the damages for the tort claim compensated for the same economic losses that were recoverable under a breach of contract claim.").

[61] *See* 48 AM. JUR. 3D *Proof of Facts* §1 (1998).

punitive damages award. This Comment advocates drawing a line and refusing to extend tort-based recovery to victims of post-contract-formation fraud, and recent commentary by the Texas Supreme Court in *Haase v. Glazner* and *LAN/STV v. Martin K. Eby Const. Co.* supports drawing the line between pre-contract-formation and post-contract-formation fraud.[62]

In *LAN/STV v. Martin K. Eby Const. Co.*, the Texas Supreme Court reaffirmed the importance of the economic-loss rule in maintaining a clear boundary between tort and contract: "Determining whether a provision for recovery of economic loss is better left to contract helps delineate between tort and contract claims."[63] Although *LAN/STV* did not involve a post-contract-formation fraud claim, it highlights the Texas Supreme Court's preference for maintaining a clear boundary between contract and tort. Refusing to extend tort-based recovery (*i.e.*, exemplary damages) in post-contract-formation situations would further the Court's preference for maintaining the boundary between contract and tort.

Years after *Presidio*, the *Haase* Court narrowed *Presidio*.[64] First, the Court held that an enforceable contract was required to (a) pursue a fraudulent-inducement claim and (b) recover benefit of the bargain damages on the contract.[65] Second and most significant, the *Haase* Court discussed how fraud and fraudulent inducement should *not* be used interchangeably with respect to the measure of damages: "Although economic losses may be recoverable under either fraud or fraudulent inducement, [*Presidio*] should not be construed to say that fraud and fraudulent inducement are interchangeable with respect to the measure of damages that would be recoverable."[66] The *Haase* Court explicitly drew a line between fraudulent inducement (i.e., pre-contract-formation fraud) and other species of fraud

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[62] *Haase*, 62 S.W.3d at 799–800; LAN/STV v. Martin K. Eby Const. Co., 435 S.W.3d 234, 239–40 (Tex. 2014).

[63] *LAN/STV*, 435 S.W.3d at 239–40. This case involved a construction dispute between a contractor and the architect who designed the plans that led the contractor to create its bid. *Id.* at 236. But it is important to note that *LAN/STV* involved claims between contractual strangers (i.e., there was no contractual privity between the contractor and the architect). *Id.* Furthermore, the only claims discussed by the Texas Supreme Court were for negligent misrepresentation and negligent performance of services. *Id.* at 244–46.

[64] *See Haase*, 62 S.W.3d at 799.

[65] *Id.*

[66] *See id.* The Court would not allow benefit-of-the-bargain damages for either a fraud claim or a fraudulent-inducement claim without a contract that satisfied the Statute of Frauds. *Id.* Nonetheless, the Court stated that the plaintiff's fraud claim for reliance damages (i.e., out-of-pocket expenses) could still survive the Statute of Frauds because they were not related to any alleged contract. *Id.*

(e.g., post-contract-formation fraud) and did not extend *Presidio*'s exception to the economic-loss rule to other species of fraud.[67] Thus, one could reasonably infer that tort-based recovery for post contract-formation fraud should not be allowed.

The lack of further guidance from the Texas Supreme Court on post-contract-formation fraud has led to a split between Texas intermediate appellate courts on pre-contract-formation and post-contract-formation fraud, which begs the question of whether tort-based recovery for post-contract-formation fraud should be allowed.

II. TEXAS COURTS SPLIT ON PRE-CONTRACT FRAUD VERSUS POST-CONTRACT-FORMATION FRAUD

This open question has split Texas intermediate appellate courts. The following discussion will illuminate the nature of the split and the competing policy rationales, concluding that plaintiffs should not be able to recover for post-contract-formation fraud claims.

A. Courts Only Allowing Recovery for Pre-contract-Formation Fraud

One strain of Texas appellate courts has held that *Presidio* only suspends the independent-injury test for fraudulent-inducement claims.[68] Thus, these courts have determined that *Presidio* does not extend to post-contract-formation fraud that only results in a loss to the subject matter of the contract.[69] In *Classical Vacations, Inc. v. Air France*, the Houston Court of Appeals (1st District) adopted this approach.[70] Air France sued Classical

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[67] *See id.*

[68] *See* Hameed Agencies (pvt) Ltd. v. J.C. Penney Purchasing Corp., No. 11-05-00140-CV, 2007 WL 431339, at *5 (Tex. App.—Eastland Feb. 8, 2007) (mem. op.); Heil Co. v. Polar Corp., 191 S.W.3d 805, 816–17 (Tex. App.—Fort Worth 2006, pet. denied); Hooker v. Nguyen, No. 14-04-00238-CV, 2005 WL 2675018, at *7 (Tex. App.—Houston [14th Dist.] Oct. 20, 2005) (mem. op.); Castle Tex. Prod. Ltd. P'ship v. Long Trusts, 134 S.W.3d 267, 274 (Tex. App.—Tyler 2003, pet. denied) ("[E]xcept [for a few] special contexts, and in the absence of independent injury, if a contract spells out the parties' respective rights regarding a particular matter, the contract, not common law tort principles, governs any dispute about that matter."); Classical Vacations, Inc. v. Air Fr., No. 01-01-01137-CV, 2003 WL 1848247, at *3 (Tex. App.—Houston [1st Dist.] Apr. 10, 2003, no pet.) (mem. op.).

[69] *See Hameed*, 2007 WL 431339, at *5; *Heil Co.*, 191 S.W.3d at 816–17; *Hooker*, 2005 WL 2675018, at *7; *Long Trusts*, 134 S.W.3d at 274; *Classical Vacations, Inc.*, 2003 WL 1848247, at *3.

[70] *Classical Vacations, Inc.*, 2003 WL 1848247, at *3.

Vacations, Inc., a travel agency, to recover the profits of ticket sales for Air France flights that Classical was supposed to have remitted to Air France.[71] The alleged fraud dealt with Classical's misreporting of the value of Air France tickets it sold and thus how much remittance was due to Air France.[72] Alleging breach of contract, fraud, and breach of fiduciary duty, Air France prevailed at its jury trial on all claims, receiving actual and exemplary damages.[73] On appeal, the Court of Appeals modified the judgment by holding that the fraud and breach of fiduciary duty findings were immaterial because the action sounded in contract alone.[74] Although Air France argued that *Presidio* applied to its fraud claim, the Court of Appeals held that it would "decline to extend [*Presidio*] to include fraud that occurs after the formation of a contract and that results only in loss to the subject of a contract."[75] Thus, the Court of Appeals refused to extend *Formosa* to post-contract-formation fraud—at least where the damages were not independent of the subject matter of the contract.[76]

The Court of Appeals cited the "independent injury" test from *DeLanney* and *Jim Walter Reed* to support its conclusion.[77] Although the Court of Appeals' holding was brief, it emphasized preventing tort recovery for mere economic loss among contractual parties.[78] The Court of Appeals stated that since all of the damages sought were based on the contract's benefit of the bargain, even if the claim bled into tort, it remained a breach of contract claim.[79] It cited *Jim Walter Reed*, noting that:

> Although the jury found Jim Walter Homes to be grossly negligent in its supervision of the construction, the Supreme Court noted that the actual damages found by the jury related only to the cost of repairing the house and, therefore, the plaintiffs were not entitled to exemplary damages. "To support an award of exemplary

[71] *Id.* at *1–2.

[72] Plaintiff's Second Amended Petition at ¶31, *Classical Vacations, Inc.*, 2003 WL 1848247.

[73] *Classical Vacations, Inc.*, 2003 WL 1848247, at *1–2.

[74] *Id.* at *3.

[75] *Id.*

[76] *Id.*

[77] *Id.* at *2.

[78] *Id.* at *2–3.

[79] *Id.* at *3.

> damages . . . , the plaintiff must prove a distinct tortious injury with actual damages."[80]

Therefore, the Court of Appeals' brief holding demonstrated its aversion to opening up an easy pathway to exemplary damages for breach of contract scenarios, which could have devastating effects on the predictability of contracts and the related transaction costs.[81]

B. Courts Allowing Recovery for Post-contract-Formation Fraud

On the other hand, three Texas Courts of Appeal (and two federal courts applying Texas law) have allowed for the possibility of tort-based recovery on post-contract-formation fraud.[82] In *Kajima International, Inc. v. Formosa Plastics Corp., USA*, Kajima International, Inc. sued Formosa Plastics Corporation, USA and Formosa Plastics Corporation, Texas for fraud, breach of contract, quantum meruit, and negligent misrepresentation arising from work performed by Kajima at Formosa's expansion plant in Point Comfort, Texas.[83] After a bifurcated jury trial in which the jury found Kajima was fraudulently induced to enter into one of its five contracts with Formosa as well as for quantum meruit recovery, the trial court ordered certain jury answers on fraud beyond the contract formation to be disregarded.[84] Kajima appealed to the Corpus Christi Court of Appeals.[85]

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[80] *Id.* at *2 (quoting Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986)) (citation omitted).

[81] *Id.* at *3; *see also* Hooker v. Nguyen, No. 14-04-00238-CV, 2005 WL 2675018, at *7 (Tex. App.—Houston [14th Dist.] Oct. 20, 2005) (mem. op.) (declined to extend *Presidio* to include post contract formation fraud that only results in loss on the subject matter of the contract.).

[82] Exxon Corp. v. Miesch, No. 13-00-00104-CV, 2012 WL 4854726, at *6 (Tex. App.—Corpus Christi Oct. 11, 2012, pet. filed) (mem. op.); Experian Info. Solutions, Inc. v. Lexington Allen, L.P., No. 4:10-CV-144, 2011 WL 1627115, at *41–42 (E.D. Tex. Apr. 7, 2011) (the economic-loss rule does not apply to fraud claims whether fraudulent inducement or other species of fraud); Paradigm Oil, Inc. v. Retamco Operating, Inc., 330 S.W.3d 342, 353–55 (Tex. App.—San Antonio 2010, pet. filed); Regus Mgmt. Grp., LLC, v. Int'l Bus. Mach. Corp., No. 3:07-CV-1799-B, 2008 WL 1836360, at*7 (N.D. Tex. Apr. 24, 2008) (denying 12(b)(6) motion to dismiss plaintiff's post-contract fraud claim on basis of economic-loss rule); Cass v. Stephens, 156 S.W.3d 38, 56 (Tex. App.—El Paso 2004, pet. denied); Kajima Int'l, Inc. v. Formosa Plastics Corp., USA, 15 S.W.3d 289, 290 (Tex. App.—Corpus Christi 2000, pet. denied).

[83] *Kajima Int'l, Inc.*, 15 S.W.3d at 290.

[84] *See id.*

[85] *See id.* at 291.

Specifically, Kajima's first issue on appeal was that the trial court erroneously refused to submit a broad form fraud question.[86] Kajima asserted that the trial court incorrectly limited the fraud question to whether Kajima was fraudulently induced by Formosa, thus restricting the jury from considering fraudulent actions that Formosa committed during the performance of the contract.[87] Formosa cited *Presidio* for the proposition that only fraudulent-inducement claims can exist in a contract setting.[88] The Court of Appeals held that it found "no language in *Presidio* to support such an interpretation."[89] The Court of Appeals first noted that its opinion in *Presidio* prior to the Supreme Court's opinion held that the trial court did not abuse its discretion by combining several species of fraud into one broad-form fraud question.[90] Second, addressing the Texas Supreme Court's opinion in *Presidio*, the Court of Appeals held that the Supreme Court limited its consideration to fraudulent inducement and did not consider other species of fraud claims: "Thus, the Supreme Court neither approved nor disapproved of our upholding the jury's finding of fraud damages for fraud in the performance of a contract."[91]

Formosa's rebuttal alleged that consideration of post-contract-formation fraud claims would explode in number because every breach of contract where a party asked the other party for continued performance would require a fraud question.[92] The Court of Appeals agreed that every "unfilled" contractual promise is not by itself fraud, but it stated that "a party's asking another party for continued performance will only trigger submission of a fraud question when the party makes a knowingly fraudulent misrepresentation to induce that performance."[93]

Additionally, the Court of Appeals noted that the Texas Supreme Court has allowed fraud recovery for inducing a party to do something not required under the contract.[94] Nevertheless, the Court of Appeals held that regardless of how the fraud question was framed in this case, there was sufficient evidence to demonstrate that Formosa made a promise to Kajima

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[86] *See id.*

[87] *See id.* at 292.

[88] *See id.*

[89] *See id. Contra* Heil Co. v. Polar Corp., 191 S.W.3d 805, 816–17 (Tex. App.—Fort Worth 2006, pet. denied).

[90] *Kajima Int'l, Inc.*, 15 S.W.3d at 292–93.

[91] *See id.* at 293.

[92] *See id.*

[93] *See id.*

[94] *See id.*

about overtime pay—outside the scope of the contract—that it had no intention of performing.[95] Therefore, the Court of Appeals held that the trial court abused its discretion by submitting a fraud question that prohibited consideration of fraud *after* contract formation when the written contracts were executed.[96]

III. COMPETING POLICY INTERESTS

The Texas Supreme Court should draw a distinction between fraudulent inducement and post-contract-formation fraud to balance the competing policy interests of (1) deterring fraud; and (2) to avoid erosion of the economic-loss rule—thus honoring parties' freedom to contract and avoiding increased transactional and societal costs. If the Texas Supreme Court fails to strike the proper balance between pre-contract-formation and post-contract-formation fraud, there will be an unpredictable and uncertain marketplace that will raise transaction costs.[97] Transaction costs will rise because parties will seek higher premiums to enter into contracts if exemplary damages are available for any breach of contract where fraud is alleged.[98] Unpredictable costs and risks will drive up the market price.[99]

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[95] *See id.*

[96] *Id.* at 294; *see* Exxon Corp. v. Miesch, No. 13-00-00104-CV, 2012 WL 4854726, at *6 (Tex. App.—Corpus Christi Oct. 11, 2012, pet. filed) (mem. op.) ("*Kajima* also rejected the argument Exxon makes here that the only type of fraud claim which can exist in a contract setting is a claim for fraud in the inducement of contracts."). *See also* Experian Info. Solutions, Inc. v. Lexington Allen, L.P., No. 4:10-CV-144, 2011 WL 1627115, at *12 (E.D. Tex. Apr. 7, 2011) (the economic-loss rule does not apply to fraud claims whether fraudulent inducement or other species of fraud (i.e., the independent-injury requirement is not necessary for other species of fraud besides fraudulent inducement)).

[97] Allowing post-formation fraud on the contract claims would raise transaction costs just like allowing no fraudulent-inducement claims because both positions are at either end of the spectrum and do not lend themselves to predictability of risk. *See* Christopher J. Faricelli, *Wading into the "Morass": An Inquiry into the Application of New Jersey's Economic Loss Rule to Fraud Claims*, 35 RUTGERS L.J. 717, 740–741 (2004); *see also* Barton, *supra* note 46, at 1832.

[98] *See supra* note 97 and accompanying text.

[99] *See, e.g.*, Joanna M. Shepherd, *Products Liability and Economic Activity: An Empirical Analysis of Tort Reform's Impact on Businesses, Employment, and Production*, 66 VAND. L. REV. 257, 273 n.85 (2013) (discussing impact of uncertainty for noneconomic damages resulting in higher insurance premiums) ("A principal conclusion emerging from surveys of actuaries and underwriters is that they will add an ambiguity premium in pricing a given risk whenever there is uncertainty regarding either the probability or losses." (quoting Howard Kunreuther & Robin M. Hogarth, *How Does Ambiguity Affect Insurance Decisions?*, in CONTRIBUTIONS TO INSURANCE ECONOMICS 307, 321 (Georges Dionne ed., 1992))).

A. Deterring Fraud

Texas like every other jurisdiction wishes to discourage fraud, an intentional tort.[100] Texas courts have long held that "fraud vitiates whatever it touches."[101] The *Presidio* holding confirmed this by allowing tort recovery for fraudulent inducement of a contract.[102] The Court held that a duty at law existed, independent of any contract, not to fraudulently procure a contract.[103] The *Presidio* Court recognized that Texas jurisprudence valued punishing an intentional tort like fraud—with little risk of attracting a hoard of illegitimate tortious interference claims: "Texas law has long imposed a duty to abstain from inducing another to enter into a contract through the use of fraudulent misrepresentations. As a rule, a party is not bound by a contract procured by fraud."[104]

With respect to contracts, Texas law has "repeatedly recognized that a fraud claim can be based on a promise made with no intention of performing, irrespective of whether the promise is later subsumed within a contract."[105] Furthermore, the Court was willing to suspend the economic-loss rule's independent-injury requirement for fraudulent inducement "irrespective of whether the fraudulent representations [were] later subsumed in a contract or whether the plaintiff only [suffered] an economic

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[100] *See* Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 47 (Tex. 1998) ("Almost 150 years ago, this Court held in Graham v. Roder, 5 Tex. 141, 149 (1849), that tort damages were recoverable based on the plaintiff's claim that he was fraudulently induced to exchange a promissory note for a tract of land."); *see also* Stoughton Trailers, Inc. v. Henkel Corp., 965 F. Supp. 1227, 1236 (W.D. Wis. 1997) ("Although it makes sense to allow parties to allocate the risk of mistakes or accidents that lead to economic losses, it does not make sense to extend the doctrine to intentional acts taken by one party to subvert the purposes of a contract.").

[101] Cox v. Upjohn Co., 913 S.W.2d 225, 231 (Tex. App.—Dallas 1995, no writ) (quoting Estate of Stonecipher v. Estate of Butts, 591 S.W.2d 806, 810 (Tex. 1979)).

[102] *See Presidio*, 960 S.W.2d at 47.

[103] *See id.*

[104] *See id.* at 46. *See, e.g.*, Prudential Ins. Co. v. Jefferson Assocs., 896 S.W.2d 156, 162 (Tex.1995); Weitzel v. Barnes, 691 S.W.2d 598, 601 (Tex. 1985); Town North Nat'l Bank v. Broaddus, 569 S.W.2d 489, 491 (Tex. 1978); Dallas Farm Mach. Co. v. Reaves, 307 S.W.2d 233, 239 (Tex. 1957).

[105] *See Presidio*, 960 S.W.2d at 46 ("For example, in Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp., 823 S.W.2d 591, 597 (Tex. 1992), we noted: 'As a general rule, the failure to perform the terms of a contract is a breach of contract, not a tort. However, when one party enters into a contract with no intention of performing, that misrepresentation may give rise to an action in fraud.'").

loss related to the subject matter of the contract."[106] To further justify its position, the *Presidio* Court referenced its holding in a prior case where it suspended the independent-injury test to allow recovery for "tortious interference with contract without the necessity of showing an independent injury differing from breach of contract."[107] Thus, the *Presidio* Court prevented the economic-loss rule from barring recovery for an intentional tort even though the damages were based on the contract.[108] These steps demonstrate the lengths that Court will go to in order to deter fraudulent behavior.

Although punishing fraud is a key public policy concern in Texas, punishing fraud in the performance of a contract would undermine the longstanding rule that even an intentional breach of contract cannot give rise to exemplary damages.[109] Whereas parties cannot "rationally calculate the possibility" of fraudulent inducement[110]—even if they could, such actions take place before the contract is ever formed—public policy has a fundamentally different interest in fraud that occurs during performance of the contract (i.e., a breach of contract).[111] That interest is honoring parties'

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[106] *Presidio*, 960 S.W.2d at 47.

[107] Wren, *supra* note 2, at 258; *see Presidio*, 960 S.W.2d at 47 ("Moreover, we have held in a similar context that tort damages were not precluded for a tortious interference with contract claim, notwithstanding the fact that the damages for the tort claim compensated for the same economic losses that were recoverable under a breach of contract claim." (quoting Am. Nat'l Petroleum Co. v. Transcon. Gas Pipe Line Corp., 798 S.W.2d 274, 278 (Tex. 1990))).

[108] *Presidio*, 960 S.W.2d at 47.

[109] Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986) (citing Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 571 (Tex. 1981)); City Prods. Corp. v. Berman, 610 S.W.2d 446, 450 (Tex. 1980)) ("Gross negligence in the breach of contract will not entitle an injured party to exemplary damages because even an intentional breach will not.").

[110] Steven C. Tourek et al., *Bucking the "Trend": The Uniform Commercial Code, the Economic Loss Doctrine, and Common Law Causes of Action for Fraud and Misrepresentation*, 84 IOWA L. REV. 875, 894 (1999).

[111] LAN/STV v. Martin K. Eby Const. Co., Inc., 435 S.W.3d 234, 240–41 (Tex. 2014) (quoting RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 1 cmt. c (Tentative Draft No. 1, 2012)); *see also* Budgetel Inns, Inc. v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1147 (E.D. Wis. 1998) ("[F]raud in the inducement by definition occurs prior to the formation of the contract itself, thus, it never constitutes a breach of contract. On the other hand, fraud in the performance of a contract is not an independent tort because the duty giving rise to the tort is established by the contract . . . . When a seller is lying about the subject matter of the contract, the party best situated to assess the risk of economic loss and allocate the risk is not the buyer, who cannot possibly know which of several statements may be a lie, but rather the seller, who clearly knows." (citations omitted)).

freedom to contract and to promote the efficiency of commercial dealings to minimize transaction costs so as to better benefit society.[112]

B. Preventing Erosion of the Economic-Loss Rule.

The Texas Supreme Court should bar tort recovery for post-contract-formation fraud to prevent erosion of the economic-loss rule, which protects two key policy interests. First, honoring parties' freedom to contract is a fundamental tenet of Texas policy because contract law is not meant to allow the state to reform parties' contracts when a party finds the contract it bargained for unfavorable.[113] Second, opening the door to tort recovery for post-contract-formation fraud increases the probability of an uncertain marketplace that results in higher costs to contract.[114]

1. Protect Parties' Freedom to Contract

The economic-loss rule recognizes that commercial entities are generally "capable of bargaining to allocate the risk of loss inherent in any commercial transaction."[115] With respect to contracts, courts should assume that the contract provides for risk allocation between the parties.[116] Absent the economic-loss rule, courts might be tempted to permit "parties to sue in tort when the deal goes awry [in order to rewrite] the agreement by allowing a party to recoup a benefit that was not part of the bargain."[117] The Supreme Court of the United States recognized the risk of drowning in a

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[112] *LAN/STV*, 435 S.W.3d at 240–41 (quoting RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 1 cmt. c (Tentative Draft No. 1, 2012)); *see generally* E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 872–73 (1986); Desnick v. Am. Brod. Cos., 44 F.3d 1345, 1354 (7th Cir. 1995).

[113] Fairfield Ins. Co. v. Stephens Martin Paving, LP, 246 S.W.3d 653, 671 (Tex. 2008) ("Texas law recognizes and protects a broad freedom of contract. We have repeatedly said that: if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider—that you are not lightly to interfere with this freedom of contract. Still, freedom of contract is not unbounded. 'As a rule, parties have the right to contract as they see fit as long as their agreement does not violate the law or public policy.'" (footnotes omitted) (quoting *In re* Prudential Ins. Co. of Am., 148 S.W.3d 124, 129 n. 11 (Tex 2004)).

[114] *E. River S.S. Corp.*, 476 U.S. at 872–73.

[115] Stoughton Trailers, Inc. v. Henkel Corp., 965 F. Supp. 1227, 1230 (W.D. Wis. 1997).

[116] *See id.*

[117] *See id.*

"sea of tort" if the economic-loss rule was discarded to allow judicial intervention into bad bargains.[118] The Court held that contract law was well suited to allocate the potential risks, especially between commercial parties, and provide adequate compensation to put the injured party in the position it would have occupied absent a breach.[119]

Honoring parties' freedom to contract is a key policy goal of Texas courts as demonstrated by the Fort Worth Court of Appeals in *D'Lux Movers & Storage v. Fulton*.[120] The plaintiff sued D'Lux, a moving company, for breach of contract and fraud after one of their glass tabletops was broken in the course of moving.[121] The tabletop broke because D'Lux had failed to crate the tabletops as contracted for.[122] D'Lux responded that their liability was limited to the contract, which contained a limitation-on-liability clause.[123] The plaintiff asserted the fraud claim because it believed it had been fraudulently induced to forgo insurance on the glass tops.[124] After the plaintiff won on both claims at a bench trial, D'Lux appealed.[125] The court of appeals reversed the trial court on the fraud claim and ordered a take-nothing judgment.[126] However, the court of appeals affirmed the breach of contract claim: it reversed and modified the damage award to comport with the contract's limitation-on-liability clause, which was triggered by D'Lux's failure to crate the glass tops.[127]

The court of appeals held that the plaintiff could not circumvent the limitation-of-liability clause by pleading fraud since the only liability resulted from the contract.[128] In essence, the court found that D'Lux was liable for mere negligent breach of contract, and it did not fraudulently

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[118] *E. River S.S. Corp.*, 476 U.S. at 866 ("Contract law, and the law of warranty in particular, is well suited to commercial controversies of the sort involved in this case because the parties may set the terms of their own agreements. The manufacturer can restrict its liability, within limits, by disclaiming warranties or limiting remedies. In exchange, the purchaser pays less for the product. Since a commercial situation generally does not involve large disparities in bargaining power, we see no reason to intrude into the parties' allocation of the risk." (citations omitted)).

[119] *Id.* at 872–73.

[120] *See generally* D'Lux Movers & Storage v. Fulton, No. 2-06-019-CV, 2007 WL 1299400 (Tex. App.—Fort Worth May 3, 2007, pet. denied).

[121] *See id.* at *1.

[122] *See id.*

[123] *See id.*

[124] *See id.* at *2.

[125] *See id.* at *3.

[126] *See id.* at *5.

[127] *See id.* at *2–3.

[128] *See id.*

induce the plaintiffs to move—even if they fraudulently induced them to forgo insurance.[129] Honoring the parties' freedom to contract, the court held that the plaintiff's fraud claim was not viable, but the plaintiff still recouped the cost of the crating since D'Lux had promised to do so but never performed as required under the contract.[130]

Honoring parties' freedom to contract has long been recognized throughout the United States as a key policy goal of contract law.[131] In maintaining a firm boundary line between tort and contract, the economic-loss rule refuses to allow governments to intervene in bad bargains:

> [U]nless the contracting plaintiff can demonstrate an independent duty that as a matter of public policy cannot be contracted away, or independent harm beyond mere disappointed economic expectations. Outside of these independent duty/independent harm situations, if the existing contract or contractual relationship fails to provide an adequate remedy, theoretically the plaintiff has only himself to blame for failing to make a better deal.[132]

Although the economic-loss rule has been applied uniformly with respect to unintentional torts, intentional torts such as fraud have caused a greater deal

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[129] *See id.* at *3.

[130] *See id.* at *2–3.

[131] *See* Cathco, Inc. v. Valentiner Crane Brunjes Onyon Architects, 944 P.2d 365, 368 (Utah 1997); Christopher Scott D'Angelo, *The Economic Loss Doctrine: Saving Contract Warranty Law from Drowning in a Sea of Torts*, 26 U. TOL. L. REV. 591, 595 (1995) ("After *East River*, courts continued to follow [the economic loss rule] . . . recognizing the sound policy reasons . . . ."); Barton, *supra* note 46, at 1823 n.215 ("Despite the nearly universal acceptance of the economic loss rule by courts, debate still surrounds the merits of the rule, particularly outside the products liability context. Critics have suggested that because tort law reduces physical injury to monetary damages, the distinction between physical injuries and economic losses is a fiction and that the rule penalizes prudent conduct by requiring plaintiffs to await physical injury prior to recovery."); *see* F. Malcolm Cunningham, Jr. & Amy L. Fischer, *The Economic Loss Rule: Deconstructing the Mixed Metaphor in Construction Cases*, 33 TORT & INS. L.J. 147, 147–48 (1997). It has also been suggested that the purpose of the rule is merely judicial economy. *See* Geri Lynn Mankoff, *Note, Florida's Economic Loss Rule: Will It Devour Fraud in the Inducement Claims When Only Economic Losses Are at Stake?*, 21 NOVA L. REV. 467, 471 (1996).

[132] Wren, *supra* note 2, at 217 (citing E. River S.S. Corp v. Transamerica Delaval, Inc., 476 U.S. 858, 870 (1986)); *see also* Neibarger v. Universal Coop., Inc., 486 N.W.2d 612, 615 (Mich. 1992) (distinguishing the purposes of contract remedies and tort remedies in a contractual relationship); Spring Motors Distribs., Inc. v. Ford Motor Co., 489 A.2d 660, 672 (N.J. 1985).

of differentiation.[133] Courts continue to struggle with maintaining the line between contract and torts.[134]

Nonetheless, the Texas Supreme Court should not allow tort recovery for post-contract-formation fraud claims at the expense of losing a distinction between tort and contract that would undermine parties' freedom to contract. The distinction between tort and contract reinforces the deeply rooted Texas policy of not awarding exemplary damages even in the face of an intentional breach.[135] Given the Texas Supreme Court's preference for limiting exceptions to the economic-loss rule, especially with respect to contract-related claims, "[t]he most obvious way to distinguish an independent tort from a breach of contract is by determining when the alleged independent tort took place."[136]

In *D.S.A., Inc. v. Hillsboro I.S.D.*, the Texas Supreme Court refused to extend *Presidio*'s suspension of the independent-injury requirement to negligent misrepresentation and negligent inducement claims: "[u]nlike fraudulent inducement, the benefit of the bargain measure of damages is not available for a claim of negligent misrepresentation . . . . Repudiating the independent-injury requirement for negligent misrepresentation claims would potentially convert every contract interpretation dispute into a negligent misrepresentation claim."[137] The Court's rationale was that since negligent misrepresentation claims cannot recover the benefit of the bargain on the contract, it would make little sense to allow an influx of negligent misrepresentation claims for any dispute on the contract.[138] Thus, the Court demonstrated its preference for limiting exceptions to the economic-loss rule to prevent an explosion of contract-related claims based in tort.[139] The

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[133] Barton, *supra* note 46, at 1824 n.215.

[134] Johnson, *supra* note 16, at 583–84 (2009) ("The economic loss rule performs a valuable function in determining which economic losses are actionable only under contract law and not under tort principles. However, just as contract law should not be allowed to drown in a 'sea of tort,' the principles of tort law should not be permitted to drown in a 'sea of contract.'" (quoting Grams v. Milk Prods., Inc., 699 N.W.2d 167, 180 (Wis. 2005) (quoting *E. River S.S. Corp.*, 476 U.S. at 866))).

[135] Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986).

[136] Budgetel Inns, Inc. v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1147 (E.D. Wis. 1998).

[137] D.S.A., Inc. v. Hillsboro Indep. Sch. Dist., 973 S.W.2d 662, 663–64 (Tex. 1998) (citing RESTATEMENT (SECOND) OF TORTS § 552 cmt. a (1977)).

[138] *Id.*

[139] *Jim Walter Homes, Inc.*, 711 S.W.2d at 618 (citing Bellefonte Underwriters Ins. Co. v. Brown, 704 S.W.2d 742 (Tex. 1986); Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 571 (Tex. 1981) ("The Reeds' injury was that the house they were promised and paid for was not the house

Court recently reinforced its preference for maintaining the boundary between tort and contract in *LAN/STV*.[140] Maintaining such a clear line between tort and contract protects parties' freedom to contract: it limits exposure to liability beyond a material breach of the contract itself.[141]

The economic-loss rule in coordination with the efficiency concerns of contract law favors eliminating any tort recovery for post-contract-formation fraud claims: "Imposing tort remedies for pure economic loss between contracting parties threatens to disrupt these risk allocations and the role of contract law, unless there is an independent reason that supersedes this concern."[142]

2. Transaction Costs and Societal Impact: The Risk of Turning Every Breach of Contract Claim into a Fraud Claim

Contract law has a deeply rooted aversion to awarding exemplary damages for a breach of contract where the damages only relate to the benefit of the bargain sought (i.e., no independent duty breached or independent injury).[143] This aversion stems from a strong undercurrent of efficiency.[144] The goal of contract remedies is "aimed at relief to promises to redress breach" not "compulsion of promisors to prevent breach."[145] Justice Holmes stated in his seminal work *The Common Law*:

> The only universal consequence of a legally binding promise is that the law makes the promisor pay damages if

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they received. This can only be characterized as a breach of contract, and breach of contract cannot support recovery of exemplary damages.").

[140] LAN/STV v. Martin K. Eby Const. Co., Inc., 435 S.W.3d 234, 239–40 (Tex. 2014) ("Determining whether a provision for recovery of economic loss is better left to contract helps delineate between tort and contract claims . . . . '[T]he underlying purpose of the economic loss rule is to preserve the distinction between contract and tort theories in circumstances where both theories could apply.'" (quoting Johnson, *supra* note 16, at 546)).

[141] *Jim Walter Homes, Inc.*, 711 S.W.2d at 618.

[142] Wren, *supra* note 2, at 215.

[143] William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 DUKE L.J. 629, 630 (1999).

[144] *See id.* at 630–31.

[145] *See* RESTATEMENT (SECOND) OF CONTRACTS, ch. 16, intro. n. (1981) ("The traditional goal of the law of contract remedies has not been compulsion of the promisor to perform his promise but compensation of the promisee for the loss resulting from breach."); E. Allan Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1147 (1970) ("Our system, then, is not directed at compulsion of promisors to prevent breach; rather, it is aimed at relief to promisees to redress breach.").

> the promised event does not come to pass. In every case it leaves him free from interference until the time for fulfillment has gone by, and therefore free to break his contract if he chooses.[146]

This philosophy of contract damages is based on the idea of "efficient breach," and is used as a contemporary justification for not awarding punitive damages for any breach of contract.[147] An efficient breach allows a breaching party to compensate the injured party and still come out ahead.[148] Nevertheless, courts tinkering with application of the economic-loss rule must balance the risk of exploitation by fraud with the reality that completing a contract may be more expensive than breaching it.

There is a deep-seated fear that excessive liability for fraud on the contract may discourage valuable commercial and economic activity and thus create an undesirable barrier to the efficient reallocation of resources.[149] Judge Posner addressed this fear:

> There is a risk of turning every breach of contract suit into a fraud suit, of circumventing the limitation that the doctrine of consideration is supposed however ineptly to place on making all promises legally enforceable, and of thwarting the rule that denies the award of punitive damages for breach of contract.[150]

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[146] OLIVER WENDELL HOLMES, JR., THE COMMON LAW 301 (1881).

[147] Dodge, *supra* note 143, at 630–32; *See* RESTATEMENT (SECOND) OF CONTRACTS ch. 16, intro. n. 1981 ("The answer provided by at least some economic analysis tends to confirm the traditional response of common-law judges in dealing with this question."); *see id.* reporter's n. ("To prevent [efficient breach] by compelling performance, it is argued, would result in a less efficient distribution of wealth since the party in breach would lose more than the injured party would gain."); *see id.* ("[A] breach of contract will result in a gain in 'economic efficiency' if the party contemplating breach . . . will gain enough from the breach to have a net benefit even though he compensates the other party for his resulting loss.").

[148] Dodge, *supra* note 143, at 629.

[149] John A. Sebert, Jr., *Punitive and Nonpecuniary Damages in Actions Based Upon Contract: Toward Achieving the Objective of Full Compensation*, 33 UCLA L. REV. 1565, 1566 (1986); s*ee also* Catherine Paskoff Chang, Note, *Two Wrongs Can Make Two Rights: Why Courts Should Allow Tortious Recovery for Intentional Concealment of Contract Breach*, 39 COLUM. J.L. & SOC. PROBS. 47, 52–53 (2005) ("Because contract law aims to facilitate market transactions, courts typically limit penalties for contract breach to those that promote market efficiency." (footnote omitted)).

[150] Desnick v. Am. Brod. Cos. Inc., 44 F.3d 1345, 1354 (7th Cir.1995).

Consequently, suspending the economic-loss rule for post-contract-formation fraud claims (*i.e.*, suspending the independent-injury requirement) would upend the commercial landscape because it would invariably turn every breach of contract suit into fraud suit.

In *Jim Walter Reed Homes*, the Texas Supreme Court explained its fear of excessive damage awards when parties had contractually allocated their risk.[151] The Reeds sued the seller/contractor of their newly constructed house because the house they were promised and paid for was not the house they received.[152] The Court held that such an injury could only be characterized as a breach of contract.[153] Furthermore, the Court held that the jury findings of gross negligence were immaterial since even an intentional breach of contract does not entitle the injured party to exemplary damages.[154] Since a breach of contract cannot support the recovery of exemplary damages, no exemplary damages were available.[155] This highlighted one of the competing policy interests: fear of excessive damage awards when the parties had contractually allocated their risk. Imposing exemplary damages on an ordinary breach of contract constitutes state intervention abridging parties' freedom to contract, which would raise transaction costs.[156] It is not the state's job to make a subjective assessment of what is a fair bargain and impose that on the parties.[157] Furthermore, the Court held that gross negligence in the breach of contract would not entitle the injured party to exemplary damages because even an intentional breach of contract will not.[158]

The economic-loss rule demarcates the different policy interests between tort and contract. Tort law seeks to protect "society's interest in freedom from harm," and this policy arises irrespective of any agreement

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[151] Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986).

[152] *See id.* at 618.

[153] *See id.*

[154] *See id.* ("Gross negligence in the breach of contract will not entitle an injured party to exemplary damages because even an intentional breach will not." (citing Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 571 (Tex. 1981); City Prods. Corp. v. Berman, 610 S.W.2d 446, 450 (Tex. 1980))).

[155] *See id.*

[156] Fairfield Ins. Co. v. Stephens Martin Paving, LP, 246 S.W.3d 653, 657–58 (Tex. 2008).

[157] *See id.* at 671.

[158] *Jim Walter Homes, Inc.*, 711 S.W.2d at 618. However, the Dallas Court of Appeals has recognized an intentional infliction of emotional distress claim related to intentionally breaching a contract on the grounds that the mental anguish is an independent injury. *See* Motsenbocker v. Potts, 863 S.W.2d 126, 138 (Tex. App.—Dallas 1993, no writ).

between the parties.[159] Contract law, on the other hand, seeks to protect "society's interest in the performance of promises."[160] Although intentional torts, such as fraud, have the power to transcend contractual arrangements between parties, this transcendence is limited by the longstanding rule that even an intentional breach of contract will not allow for tort recovery.[161] The delicate balance between discouraging fraud and preventing erosion of the economic-loss rule is only maintained by providing a clear demarcation between pre-formation and post-formation fraud:

> This is exactly how the fraud-in-the-inducement and fraud-in-the-performance of a contract distinction was intended to operate. Sellers are not faced with an independent duty to protect buyers from economic loss; rather that duty is provided for by the parties' mutual agreement or contract. On the other hand, there is a common-law duty not to induce another into a contract by fraudulent means. The key, then, is to strike a balance between the two concerns.[162]

The failure to strike the balance between "fraud-in-the-inducement" and "fraud-in-the-performance" would drastically raise the transaction costs of contracts since virtually every breach of contract dispute could turn into a fraud claim with the possibility of exemplary damages. Such a failure would undermine the predominant efficiency concerns of contract law and greatly raise the cost of commercial dealings to society as a whole.

Accordingly, the Texas Supreme Court should recognize that the best way to preserve the economic-loss rule and minimize societal costs to contract is to impose the economic-loss rule's independent-injury requirement on post-contract-formation fraud claims. "[E]xcept [for a few] special contexts, and in the absence of independent injury, if a contract spells out the parties' respective rights regarding a particular matter, the contract, not common law tort principles, governs any dispute about that matter."[163]

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[159] Unifoil Corp. v. Cheque Printers & Encoders Ltd., 622 F. Supp. 268, 270–71 (D.N.J. 1985) (citing Spring Motors Distribs., Inc. v. Ford Motor Co., 489 A.2d 660, 672 (N.J. 1985)).

[160] *Id*.

[161] *See id.*

[162] Faricelli, *supra* note 97, at 740–41.

[163] Castle Tex. Prod. Ltd. P'ship v. Long Trusts, 134 S.W.3d 267, 274 (Tex. App.—Tyler 2003, pet. denied).

IV. CONSEQUENCES OF ONLY ALLOWING PRE-CONTRACT-FORMATION FRAUD CLAIMS IN TEXAS

The distinction between fraud pre- and post-contract formation advocated for here would not foreclose all opportunities for tort recovery on actions post-contract formation. Some Texas courts have already found an "exception" to the pre- and post-contract-formation distinction by allowing tort recovery for fraudulent inducement of extra-contractual rights and obligations in the midst of a preexisting contractual relationship.[164] Thus, a preexisting contract may serve as a conduit for tort recovery when a party is fraudulently induced to perform beyond the original contract.[165]

For example, in *Cass v. Stephens* the court of appeals held that an oil and gas operator, operating under a preexisting joint operating agreement, was liable for fraudulent inducement because of fraudulent billing.[166] Working interests owners sued the oil and gas operator for breach of contract, conversion, and fraud.[167] An audit of the wells run by the operator revealed almost $12 million in discrepancies.[168] The jury returned a verdict finding the oil and gas operator liable on all three claims.[169] The working interest owners' petition specifically delineated between the acts that constituted breach of contract, fraud, and conversion: the "numerous categories of overcharges and the charges for expenses not authorized by the JOAs" were alleged as breach of contract injuries.[170] The "charges for expenses related to the operator's companion wells and the charges for property already owned by the joint owners as fraud injuries."[171]

The court of appeals affirmed the trial court's judgment for the working interest owners over the operator's appeal that the alleged injuries were limited to the contract.[172] As to the fraud claims, the court of appeals held that the operator had fraudulently induced the working interest owners to pay for goods and services never received.[173] The court of appeals justified this conclusion on the basis that the JOAs did not authorize the operator to

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[164] *See, e.g.*, Cass v. Stephens, 156 S.W.3d 38, 68–69 (Tex. App.—El Paso 2004, pet. denied).

[165] *See id.*

[166] See id.

[167] See id. at 47.

[168] See id. at 49.

[169] See id. at 51.

[170] See id. at 68.

[171] See id.

[172] See id. at 68–69.

[173] See id.

bill the working interest owners' account for expenses on the operator's companion wells, or to double-bill for equipment already owned.[174] Although the agreements "created a conduit for committing the torts," the duty the operator breached was independent of the agreement according to the court of appeals.[175]

Admittedly, *Cass*'s discussion of contorts may be lacking,[176] but *Cass* recognized that actions may occur in the midst of an ongoing contractual relationship that fall outside the scope of the contract.[177] Fraudulent inducement *includes* inducing a party to do something not required under the contract.[178] Just like the injured party cannot dress up a breach of contract claim as a tort claim, the culpable party cannot hide its tort within a contract that brought the parties together.[179] Therefore, any fraudulent inducement beyond what is required under the contract is still governed by *Presidio* and does not properly fall within the fraud-in-the-performance-of-the-contract context. This could be viewed as an "exception" to the fraud pre- and post-contract formation distinction since it goes beyond the parties' contractually allocated risk and obligations.

Similarly, in *Paradigm Oil, Inc. v. Retamco Operating, Inc.*, an oil-and-gas-lease transferee and its assigns' failure to honor reversionary rights pursuant to a purchase agreement was considered post-contract-formation fraud.[180] The transferee and its assigns argued that tort recovery awarded by the trial court was inappropriate because the economic-loss rule prohibited contract claims dressed up as tort claims.[181] The court of appeals rejected this argument since there was sufficient evidence that the transferee and its assigns had engaged in a deliberate scheme to defraud the transferor of its

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[174] See id. at 68.

[175] See id. at 69.

[176] For example, despite being decided after *Presidio*, the court of appeals discusses the nature of the injury test even though that is not required for fraudulent inducement. *Id.* It holds *a fortiori* any damages resulting from breach of a duty independent of the contract are tortious in nature, regardless of being merely economic damages. *Id.* However, *Presidio's* language more strongly suggests that the nature of the injury requirement under *DeLanney* is merely suspended for fraudulent inducement. Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 47 (Tex. 1998).

[177] *See, e.g.*, Kajima Int'l, Inc. v. Formosa Plastics Corp., USA, 15 S.W.3d 289, 290 (Tex. App.—Corpus Christi 2000, pet. denied).

[178] *See, e.g.*, Cass, 156 S.W.3d at 68–69.

[179] *See, e.g.*, *id.*

[180] Paradigm Oil, Inc. v. Retamco Operating, Inc., 330 S.W.3d 342, 355 (Tex. App.—San Antonio 2010), *rev'd on other grounds,* 372 S.W.3d 177 (Tex. 2012).

[181] *Id.* at 353–54.

reversionary rights by "overcharging and misstating expenses for which claims and damages are separate from the breach of contract claims."[182] Adopting the approach in *Cass*, the court of appeals held that as a matter of law, *overcharging and misstating expenses* in the midst of contractual relationship was beyond the scope of the contract and subject to tort recovery.[183]

The unique distinction that these two courts of appeals have made with respect to overcharging and misstating expenses based on a preexisting contract raises the question of whether inducing parties to do something not required by the contract should allow tort recovery.[184] Especially since the contract creates the preexisting relationship that governs parties' allocation of risk and obligations, thus determining whether there *is* an overcharge or misstated expense. The "exception" to post-contract-formation fraud in *Cass* and *Paradigm Oil, Inc.* could pose a risk to eroding the economic-loss rule, especially the independent-injury test. Accordingly, it could be overruled or limited to particularly egregious circumstances.[185] Ultimately, allowing *Cass*-like scenarios of fraudulent billing as an "exception" to the pre-and post-contract-formation distinction would simply honor the same principles that justify tort recovery for fraudulent inducement since such actions are *beyond the scope* of the existing contract and effectively recreate the formation environment.[186]

In pre-contract-formation fraud, parties have not yet formed a contract to contractually allocate their risks and cannot be expected to allocate the

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[182] *See id.* at 355.

[183] *See id.*

[184] *See id.*; Cass, 156 S.W.3d at 68–69.

[185] An additional factor in the balance in *Cass* and *Paradigm* could be Texas policy favoring the most efficient means of getting oil and gas to market. *See, e.g.*, Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1, 27 (Tex. 2008) (Willett, J., concurring) ("Our fast-growing State confronts fast-growing energy needs, and Texas can ill afford its finite resources, or its law, to remain stuck in the ground. The Court today averts an improvident decision that, in terms of its real-world impact, would have been a legal dry hole, juris-imprudence that turned booms into busts and torrents into trickles. Scarcity exists, but *above*-ground supply obstacles also exist, and this Court shouldn't be one of them.").

[186] Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41, 46–47 (Tex. 1998). ("Similarly, in Spoljaric v. Percival Tours, Inc., 708 S.W.2d 432, 434 (Tex.1986), we held that a fraud claim could be maintained, under the particular facts of that case, for the breach of an oral agreement to pay a bonus because a 'promise to do an act in the future is actionable fraud when made with the intention, design and purpose of deceiving, and with no intention of performing the act.'"); *accord* T.O. Stanley Boot Co. v. Bank of El Paso, 847 S.W.2d 218, 222 (Tex.1992); Stanfield v. O'Boyle, 462 S.W.2d 270, 272 (Tex.1971).

risk of fraudulent inducement—otherwise contract costs would skyrocket.[187] Likewise, parties should not be presumed to have contractually allocated risks *beyond* the terms of the contract.[188] Subsequent modifications recreate the formation environment with respect to the new rights and obligations being requested.[189] The recreation of the formation environment justifies applying fraudulent inducement principles. Otherwise, an unscrupulous party could enter into a contract completely above bar and subsequently seek modification of the contract in a fraudulent manner. On the other hand, one could argue that such a scenario is impossible if the unscrupulous party had such designs coming into the contract (*i.e.*, it would amount to fraudulent inducement), but then the burden of proof may be difficult for the injured party trying to prove that the unscrupulous party had fraudulent designs all along.

V. CONCLUSION

The best solution to the Texas appellate court split on whether to allow recovery of damages on the contract for post-contract-formation fraud requires resolving competing policy interests: (1) to discourage fraud in contractual dealings; and (2) to prevent erosion of the economic-loss rule, thus respecting parties' freedom to contract while minimizing transaction costs. But a proper balance cannot be achieved without making a distinction between pre- and post-contract-formation fraud. Thus, Texas courts should not allow recovery in tort for post-contract-formation fraud, unless such fraud goes beyond the scope of the contract's terms.

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[187] *See* Stoughton Trailers, Inc. v. Henkel Corp., 965 F. Supp. 1227, 1230 (W.D. Wis. 1997); Tourek et al., *supra* note 110, at 894; *see also* Budgetel Inns, Inc. v. Micros Sys., Inc., 8 F. Supp. 2d 1137, 1147–48 (E.D. Wis. 1998) ("[F]raud in the inducement by definition occurs prior to the formation of the contract itself, thus, it never constitutes a breach of contract. On the other hand, fraud in the performance of a contract is not an independent tort because the duty giving rise to the tort is established by the contract . . . . When a seller is lying about the subject matter of the contract, the party best situated to assess the risk of economic loss and allocate the risk is not the buyer, who cannot possibly know which of several statements may be a lie, but rather the seller, who clearly knows." (citations omitted)).

[188] *See* Paradigm Oil, Inc. v. Retamco Operating, Inc., 330 S.W.3d 342, 355 (Tex. App.—San Antonio 2010), *rev'd on other grounds*, 372 S.W.3d 177 (Tex. 2012); Cass, 156 S.W.3d at 68–69; *see also Stoughton Trailers, Inc.*, 965 F. Supp. at 1236 ("Although it makes sense to allow parties to allocate the risk of mistakes or accidents that lead to economic losses, it does not make sense to extend the doctrine to intentional acts taken by one party to subvert the purposes of a contract.").

[189] *See* El Paso Field Servs., L.P. v. MasTec N. Am., Inc., 389 S.W.3d 802, 810–12 (Tex. 2012).