

THE GHOST OF TEXAS SUPREME COURT FRAUD JURISPRUDENCE: HOW
LATER-IN-TIME DTPA DECISIONS LED COURTS TO FORGET THE
FIRST-IN-TIME MEASURE OF DAMAGES FOR FRAUD

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INTRODUCTION

If an opinion sits proudly on the library shelf but grows forgotten with the passage of time, does its holding still have any force? In *Mitschke v. Borromeo*, the Texas Supreme Court recently exerted considerable effort reaffirming the common law's "commitment to precedent."¹ The court did so in the context of concluding that the intermediate appellate courts should not be free to wobble back and forth between inconsistent pronouncements by different panels.²

Mitschke rightly explained that such departures from *stare decisis* often occur because the lawyers failed to point out the key precedent: "Most such 'violations' are presumably inadvertent, as when parties fail to identify binding precedents. Despite lawyers' and judges' best efforts, deviations of that sort are inevitable, especially in busy and large appellate courts."³ Regardless of the reason for the departure, however, the earlier decision ought to control: "If last-in-time decisions trumped earlier decisions, the public writ large would unfairly bear the consequences of departures from *stare decisis*."⁴

What if this kind of departure takes place in a court of last resort? Should the earlier decision still control? These questions deserve a look because just such a departure seems to have taken place with the measure of damages for fraudulent inducement. Lawyers have not done as good of a job as they should have in letting courts know what precedent says about the measure, so this Article hopes to fill a bit of the gap. The measure of damages for a common-law tort may sound like something old and stable, but lawyers sometimes forget a precedent or leave that precedent aside because they feel that they can win by focusing on other points.

A century ago, the Texas courts stood at a crossroads regarding this measure of damages. One road lets fraud plaintiffs recover benefit-of-the-bargain damages, while the other road limits fraud plaintiffs to out-of-pocket damages. In the 1906 decision in *George v. Hesse*,⁵ the Texas Supreme Court chose the more restrictive road. The Texas courts then spent the rest of the

¹ *Mitschke v. Borromeo*, 645 S.W.3d 251, 257 (Tex. 2022).

² *Id.* ("If one appellate panel decides a case, and another panel of the same court differently resolves a materially indistinguishable question in contravention of a holding in the prior decision, the second panel has violated the foundational rule of *stare decisis*.").

³ *Id.* at n.11.

⁴ *Id.*

⁵ 93 S.W. 107, 107 (Tex. 1906).

twentieth century restricting fraud damages to the smaller measure allowed by the out-of-pocket rule.

Remarkably, however, the courts circled back to that crossroads without even realizing it. The backtracking started innocently enough, when the courts began deciding issues of statutory misrepresentation under the Deceptive Trade Practices Act (DTPA)⁶ by analogizing to general features of the common law. The DTPA was new and interesting back in the 1970s and 1980s, whereas torts like fraud were old and familiar, so attention moved toward construing the statute. But as the courts fleshed out the new consumer protection statute, some of their passing remarks about common-law background rules accidentally spilled over from DTPA cases into fraud cases. In dictum in *Formosa Plastics Corp. v. Presidio Eng'rs & Constructors, Inc.*,⁷ Texas started down the benefit-of-the-bargain road. It remains to be seen how the Texas Supreme Court will handle the conflict between the *Formosa* language and the court's own cases going back to *George v. Hesse*. Will the court's renewed emphasis on precedent carry the day?

Were it not for *Mitschke*, one might expect the system simply to soldier along and treat the 1906 pronouncement in *George v. Hesse* as a mere historical asterisk, an obsolete ruling with no right to receive any weight in our enlightened era. But *Mitschke* calls for a different conclusion. Consider how far the court went out of its way in *Mitschke* to expound on stare decisis. Section II of the opinion could have been omitted entirely, because it deals with the rules of precedent for intermediate appellate courts, a topic that the court could have jumped over on the way to deciding whether petitioner's appeal was timely or late.⁸ The timeliness of petitioner's appeal depended solely on the viability of a supreme court decision from decades earlier—the focus of Section III of the opinion—and did not depend in the slightest on how courts of appeals ought to handle their internal housekeeping.⁹ But Section II made a point about how important stare decisis is in the legal system. On top of that, Section III then emphasized that departures from precedent “must be carefully considered”¹⁰ and “always requires careful and

⁶TEX. BUS. & COM. CODE §§ 17.41–63.

⁷960 S.W.2d 41, 49 (Tex. 1998).

⁸See *Mitschke*, 645 S.W.3d at 255–58.

⁹See *id.* at 258–66 (addressing and overruling *Philbrook v. Berry*, 683 S.W.2d 378 (Tex. 1985)).

¹⁰*Id.* at 263.

respectful analysis.”¹¹ Given this guidance, the time has come for such careful consideration to the first-in-time holding in *George v. Hesse*.

I. THE TRADITIONAL INSISTENCE ON THE OUT-OF-POCKET RULE

There is nothing new about fraud. Its measure of damages today surely ought to look a great deal like its measure long ago. So it is no surprise that the early Texas cases sound very similar to the modern ones.

A. 1882 to 1972: the Texas Supreme Court treated the out-of-pocket rule as the only measure of damages for fraud.

The first significant Texas case to address the measure of damages for fraud is *Greenwood v. Pierce*.¹² In *Greenwood*, the defendant alleged fraudulent inducement in his answer to the plaintiff’s suit for collection on a note.¹³ The court stated that the measure of damages for fraudulent inducement should be calculated by using the out-of-pocket rule: “In a suit of this character, the measure of damages for failing to comply with the assurances upon which the property was sold would ordinarily be the difference between the contract price and the actual value of the property.”¹⁴

1. English and federal cases used the out-of-pocket rule.

It is worth pausing to clarify what one means by speaking of “the law” in Texas. In the days of *Greenwood*, “the law” might depend on whether the case went to state court or federal court, because there was no *Erie* doctrine. The federal courts of that era still followed the rule of *Swift v. Tyson*,¹⁵ which allowed federal courts to apply “general federal common law.” Only in 1938 did that change.¹⁶ In addition, Texas has traditionally taken some guidance from English common law.¹⁷ For these reasons, it is worth consulting the

¹¹ *Id.* at 266.

¹² 58 Tex. 130 (1882).

¹³ *Id.* at 131.

¹⁴ *Id.* at 133.

¹⁵ 41 U.S. (16 Pet.) 1 (1842), *overruled by* *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938).

¹⁶ *Erie*, 304 U.S. at 69–70.

¹⁷ See TEX. CIV. PRAC. & REM. CODE § 5.001 (“The rule of decision in this state consists of those portions of the common law of England that are not inconsistent with the constitution or the laws of this state, the constitution of this state, and the laws of this state.”).

English and federal cases of a century ago. Those cases consistently espoused the out-of-pocket rule.

The leading English case was *Peek v. Derry*,¹⁸ where the Court of Appeal held that fraud damages must be measured by the out-of-pocket rule.¹⁹ That aspect of *Peek v. Derry* played a role in persuading the Texas courts to use the out-of-pocket rule.

In 1899 the question came before the United States Supreme Court in *Smith v. Bolles*.²⁰ The Court unanimously held that a fraud plaintiff was limited to the out-of-pocket measure.²¹ The Court stated: “The measure of damages was not the difference between the contract price and the reasonable market value if the property had been as represented to be, even if the stock had been worth the price paid for it; nor, if the stock were worthless, could the plaintiff have recovered the value it would have had if the property had been equal to the representations. What the plaintiff might have gained is not the question, but what he had lost by being deceived into the purchase.”²²

The Court recognized that the fraud-feasor had to pay at least something in the way of damages, but not the benefit-of-the-bargain:

The gist of the action was that the plaintiff was fraudulently induced by the defendant to purchase stock upon the faith of certain false and fraudulent representations, and so as to the other persons on whose claims the plaintiff sought to recover. If the jury believed from the evidence that the defendant was guilty of the fraudulent and false representations alleged, and that the purchase of stock had been made in reliance thereon, then the defendant was liable to respond in such damages as naturally and proximately resulted from the fraud. He was bound to make good the loss sustained,—such as the moneys the plaintiff had paid out and interest, and any other outlay legitimately attributable to

¹⁸ [1887] 37 Ch D 541 (Eng.).

¹⁹ *Id.* On further appeal to the House of Lords, the judgment was reversed on other grounds. *Derry v. Peek*, [1889] 14 App. Cas. 337. But the House of Lords did not disturb the damage measure laid down by the Court of Appeal.

²⁰ 132 U.S. 125 (1889).

²¹ *Id.* at 129–30.

²² *Id.* at 129.

defendant's fraudulent conduct; but this liability did not include the expected fruits of an unrealized speculation.²³

In fact, the Court concluded that the value as represented was not even relevant.²⁴

A year later, the United States Supreme Court repeated its view that a fraud plaintiff was not entitled to recover the benefit-of-the-bargain.²⁵ The Court again disparaged benefit-of-the-bargain damages as “the expected fruits of an unrealized speculation.”²⁶ The Court reasoned:

We adhere to the doctrine of *Smith v. Bolles*. Upon the assumption that the property was not worth what the plaintiffs agreed to give for it, they were entitled to have—if the evidence sustained the allegation of false and fraudulent representations upon which they were entitled to rely and upon which they in fact relied—a verdict and judgment representing in damages the difference between the real value of the property at the date of its sale to the plaintiffs and the price paid for it, with interest from that date, and, in addition, such outlays as were legitimately attributable to the defendant's conduct, but not damages covering “the expected fruits of an unrealized speculation.” If the plaintiffs were inveigled by the fraud of the defendant into purchasing this mining property, a judgment of the character just indicated would make them whole on account of the loss they sustained. More they are not entitled to have at the hands of the law in this action.²⁷

For support, the Court relied on *Peek v. Derry*,²⁸ where the Court of Appeal had reached the same conclusion.²⁹

²³ *Id.* at 129–30.

²⁴ *See id.* at 130 (“The reasonable market value, if the property had been as represented, afforded, therefore, no proper element of recovery.”).

²⁵ *Sigafus v. Porter*, 179 U.S. 116, 125 (1900).

²⁶ *Id.* (quoting *Smith*, 132 U.S. at 130).

²⁷ *Id.*

²⁸ [1887] 37 Ch D 541 (Eng.).

²⁹ *Porter*, 179 U.S. 116 at 124; *see also* *W.P. Walker & Co. v. Walbridge*, 136 F. 19, 26–27 (5th Cir. 1905) (Shelby, J., dissenting) (urging use of the out-of-pocket rule on the authority of *Sigafus v. Porter*, *Smith v. Bolles*, *Peek v. Derry*, and *Greenwood v. Pierce*).

2. The Texas Supreme Court consistently agreed with English and federal courts that the out-of-pocket measure was the only proper measure.

Against this background of English and federal authority, the Texas Supreme Court eventually confronted a case where the issue of the proper measure of damages was cleanly presented. The case is *George v. Hesse*.³⁰

The case involved some land in Dimmitt County.³¹ The landowner was a San Antonio farmer named Mr. George.³² Mr. George wanted to sell some real estate to Mr. Hesse.³³ As an inducement, George told Hesse that “he had been boring a well upon said land for artesian water, and had just struck a gusher of water.”³⁴

Hesse bought the land, thinking that he was now the proud owner of a piece of land with a gusher of water.³⁵ But the gusher did not exist.³⁶

Hesse sued George for fraud.³⁷ He alleged damages of \$4,474, which was the difference “in value of the land at the date of the transaction, with and without an artesian well.”³⁸ That is, he alleged the benefit-of-the-bargain measure.³⁹ Hesse persuaded the jury, and the district court awarded him a judgment for \$4,474.⁴⁰

Defendant George appealed to the San Antonio Court of Civil Appeals, complaining about the benefit-of-the-bargain measure.⁴¹ After a mildly convoluted discussion, the court of civil appeals concluded that George’s complaint was valid.⁴² The court held that the benefit-of-the-bargain measure

³⁰93 S.W. 107 (Tex. 1906).

³¹*Id.* at 107.

³²*Id.*

³³*Id.*

³⁴*George v. Hesse*, 94 S.W. 1122, 1123 (Tex. Civ. App.—San Antonio 1906) (“[A]n artesian well from which gushed a strong, heavy flow of water.”).

³⁵*George*, 94 S.W. at 1123.

³⁶*Id.*

³⁷*Id.*

³⁸*Id.*

³⁹*Id.* at 1124–25.

⁴⁰*Id.* at 1123.

⁴¹*Id.* at 1124.

⁴²*Id.* at 1125.

was improper.⁴³ On rehearing, however, the court of civil appeals decided to certify the question to the Texas Supreme Court.⁴⁴

The Texas Supreme Court responded by rejecting the benefit-of-the-bargain measure in a loud voice.⁴⁵ The court embraced the out-of-pocket measure instead:

There is a conflict of authority upon the point; but it seems to us, that the difference of opinion grows out of a confusion as to the nature of the cause of the action. This is not a case in which the plaintiff sues for the breach of a contract, for the contract has been performed by both parties. But it is a case in which the plaintiff sues to recover damages for a fraudulent representation by which he has been induced to enter into a contract to his loss. Clearly, we think, the extent of his loss is the difference between the value of that which he has parted with, and the value of that which he has received under the agreement. The contract in this case was not to convey a tract of land with a “gusher” on it; but was to convey a certain tract of land, which was falsely represented to have a “gusher” on it, which false representation was an inducement which led to the contract. Logically, therefore, what he has lost by the transaction is the measure of his damages.⁴⁶

For support, the Texas Supreme Court relied on the English case of *Peek v. Derry*, and the United States Supreme Court decisions in *Smith v. Bolles* and *Sigafus v. Porter*.⁴⁷ Thus, the Texas Supreme Court backed up the San Antonio Court of Civil Appeals, which promptly overruled the motion for rehearing.⁴⁸

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *George v. Hesse*, 93 S.W. 107, 107–08 (Tex. 1906).

⁴⁶ *Id.* at 107. Accordingly, “if the plaintiff recovers a sufficient sum in money to make that which he has received equal to that which he has conveyed, and that which he has assumed to pay, he is compensated for his loss, and, as we think, that is the measure of his damages.” *Id.* at 108.

⁴⁷ *Id.* at 107.

⁴⁸ *See George*, 94 S.W. at 1125 (“The question of the correctness of the rule applied by the trial court for the measure of damages was submitted by us to the Supreme Court by certified question, and has been determined by that court. This decision established the rule to be applied.” (citation omitted)).

The 1906 decision in *George v. Hesse* has never been expressly questioned or assailed, let alone reconsidered and overruled. So, if a modern-day lawyer had to pick a single opinion to support an argument against the benefit-of-the-bargain rule and in favor of the out-of-pocket rule, he or she could hardly do better than to pick *George v. Hesse*. Yet there is no need to confine oneself to that opinion alone.

To understand cases arising after *George v. Hesse*, one must take note of a fraud statute that affected some kinds of cases. In 1919, the Texas Legislature modified the measure of damages for fraud in certain cases of real estate fraud or stock fraud.⁴⁹ The 1919 statute—now codified at TEX. BUS. & COM. CODE ANN. § 27.01—was simply known as Article 4004.⁵⁰ The statute authorized use of the benefit-of-the-bargain measure for transactions meeting the elements of the statute.⁵¹

The statute was relatively narrow. The mere involvement of a tract of land in the transaction would not suffice to trigger the statute.⁵² Instead, the courts gave the statute a narrow reading, on the ground that it “is penal in nature and must be strictly construed.”⁵³

A later part of this article examines the linkage between the statute of frauds and statutory real estate fraud.⁵⁴ For now, the point is that in all cases of common-law (i.e., non-statutory) fraud, the rule continued to be that the plaintiff suing for common law fraud must use the out-of-pocket measure.

⁴⁹TEX. BUS. & COM. CODE ANN. § 27.01.

⁵⁰See TEX. REV. CIV. STAT. ANN. art. 4004.

⁵¹See *Sibley v. Southland Life Ins. Co.*, 36 S.W.2d 145, 146 (Tex. 1931) (“The rule announced in the year 1906, in the case of *George v. Hesse* . . . has been supplemented, if not superseded, by the above statutory rule”); see *El Paso Dev. Co. v. Ravel*, 339 S.W.2d 360, 363 (Tex. Civ. App.—El Paso 1960, writ ref’d n.r.e.) (“The statute (Art. 4004) enlarged the measure of damages from the ‘out of pocket’ damages allowed by the rule announced in the *Hesse* case (supra) to the damages which are measured by the difference between the value of the property as represented, or as it would have been worth had the promise been fulfilled, and the actual value of the property in the condition in which it is delivered or received at the time of the contract. The statutory measure of damages is sometimes referred to as the ‘benefit of the bargain’ rule.”). Curiously, the statute was amended in 1983 to eliminate all reference to the measure of damages. One wonders what the right measure of damages is now in a case of statutory fraud, but that is a question for another day.

⁵²TEX. BUS. & COM. CODE ANN. § 27.01.

⁵³*Westcliff Co. v. Wall*, 267 S.W.2d 544, 546 (Tex. 1954); see *Loma Vista Dev. Co. v. Johnson*, 180 S.W.2d 922, 924 (Tex. 1944) (referring to “the drastic penalty prescribed by Art. 4004”).

⁵⁴See *infra* Section II.A.

This is apparent from a collection of cases from the Commission of Appeals.⁵⁵

When one is seeking to trace a rule's precedential pedigree, Commission of Appeals cases feel unsatisfying. But the Commission of Appeals cases on common-law fraud during the early twentieth century carry extra punch. This is because of their narrow facts and the resulting impossibility of securing Texas Supreme Court approval if the high court had not believed in the out-of-pocket rule. For example, in *Cox v. Barton*,⁵⁶ the Commission of Appeals extended *George v. Hesse* beyond fraud to cases of mutual mistake, saying: "It seems to us that there is a much stronger reason for applying the rule announced in *George v. Hesse* in cases involving mutual mistake than in cases of fraud, and we are of opinion that the rule announced in that case should be followed and applied in this case."⁵⁷ The Texas Supreme Court not only adopted the Commission's judgment but also endorsed its reasoning: "We approve the holding of the Commission on the question of the measure of damages, as to which the reversal is ordered."⁵⁸

The next important decision is *Morriss-Buick Co. v. Pondrom*.⁵⁹ *Morriss-Buick* is exceedingly strong authority for the out-of-pocket rule, and it stands right behind *George v. Hesse* in its authoritativeness.⁶⁰ The opinion originated with the Commission of Appeals but was adopted outright by the Texas Supreme Court.⁶¹ The opinion came out just two months before Justice

⁵⁵ *E.g.*, *Booth v. Coward*, 265 S.W. 1026, 1027 (Tex. Comm'n App. 1924, judgment adopted); *see Vogt v. Smalley*, 210 S.W. 511, 512 (Tex. Comm'n App. 1919) ("The writ of error was granted in this case solely on the question of the measure of damages, and on the authority of *George v. Hesse*, 93 S. W. 107 That decision furnishes the proper rule in cases of this character. The Court of Civil Appeals having, for a proper reason, reversed the trial court judgment and remanded the cause for another trial, its judgment to that effect will be affirmed, as recommended by the Commission of Appeals.").

⁵⁶ 212 S.W. 652 (Tex. Comm'n App. 1919, holding approved, judgment adopted).

⁵⁷ *Id.* at 654.

⁵⁸ *Id.*; *see also* *Rea v. Luse*, 231 S.W. 310, 312 (Tex. Comm'n App. 1921, judgment adopted) ("The measure of damage in such case is the difference between the value of that parted with by the party defrauded, and that received (*George v. Hesse, supra*), and is the measure that should have been applied herein by the trial court."); *Moore v. Beakley*, 215 S.W. 957, 958 (Tex. Comm'n App. 1919, holding approved, judgment adopted) ("The measure of damages in a case of this character is the difference between the value of the property received and that given in exchange, at the time of the exchange.").

⁵⁹ 113 S.W.2d 889 (Tex. [Comm'n Op.] 1938).

⁶⁰ *Id.* at 890.

⁶¹ *Id.* at 890-91.

Brandeis handed down his landmark opinion creating the *Erie* doctrine, overruling *Swift v. Tyson*, and abolishing the old doctrine of general federal common law.⁶² With the demise of general federal common law, Texas litigants in federal court were no longer bound by the United States Supreme Court's pronouncements in *Smith v. Bolles* and *Sigafus v. Porter*. But with *George v. Hesse*, who needed those cases?

The *Morriss-Buick* litigation consists of two connected cases. The fact that *Morriss-Buick* involved a couple of used cars (1929 Buick sedans) serves as a reminder of how little fraud cases have changed over the years. Two different buyers, Huss and Pondrom, ended up hiring the same law firm to represent them in their fraud cases against the dealership.⁶³ Each buyer had an older Buick that he wanted to trade in for a newer version.⁶⁴ It was late 1929, just before the crash, and Buick had just released the brand new 1930 models, so it was time to start getting rid of the 1929 models.⁶⁵

Here is what happened to Huss. Huss had a 1928 Buick sedan, but he wanted a 1929 model.⁶⁶ The cost was \$1,525.⁶⁷ He came up with the money by signing a note for \$825 and by getting a \$700 credit for the trade-in of his old car.⁶⁸ The car acted like a lemon, whereupon Huss discovered that it was not new after all but had actually been wrecked, repaired, and sold as new.⁶⁹

Huss brought a fraud case against the dealership, *Morriss-Buick Company*.⁷⁰ He won at trial.⁷¹ *Morriss-Buick* appealed, complaining about the measure of damages.⁷² The complaint was essentially that instead of making the jury use the out-of-pocket measure required by *George v. Hesse*, the trial court had treated the agreed-upon trade-in figure of \$700 as binding.⁷³ In other words, *Morriss-Buick* wanted the jury to do the math on its own, rather than having the trial court force the jury to accept the \$700

⁶² *Erie R. Co. v. Tompkins*, 304 U.S. 64, 79 (1938).

⁶³ See *Pondrom*, 113 S.W.2d at 889; *Morriss-Buick Co. v. Huss*, 84 S.W.2d 264, 265 (Tex. App.—Dallas 1935), *rev'd*, 113 S.W.2d 891 (Tex. [Comm'n Op.] 1938).

⁶⁴ *Pondrom*, 113 S.W.2d at 890; *Huss*, 84 S.W.2d at 265.

⁶⁵ *Huss*, 84 S.W.2d at 265.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.* at 266.

⁷² *Id.*

⁷³ *Id.*

figure as binding. Apparently, Morriss-Buick thought that the jury might value the trade-in at less than the generous \$700 number that formed part of the deal; after all, if Huss had given up an old model worth something less than \$700, then his out-of-pocket loss would be reduced by that amount.

The Dallas Court of Civil Appeals acknowledged *George v. Hesse* but found it distinguishable.⁷⁴ The Dallas court agreed that under *George v. Hesse*, the jury would have needed to figure the value of the trade-in as a step in calculating the out-of-pocket loss.⁷⁵ But the court refused to treat the transaction globally.⁷⁶ Instead, the court more or less took the \$700 trade-in figure at face value as part of a separate sale.⁷⁷ The Dallas court thus held that the parties had agreed on \$700 as the value of the trade-in, and that the jury was stuck with that number to use in its damage calculations: “we find that the used Buick sedan, taken in on the sale, was considered by the parties as the equivalent of a cash payment of \$700 on the purchase price.”⁷⁸

With only slight variations in the numbers, the same thing happened to Pondrom.⁷⁹ The Dallas court adopted its discussion from *Huss* without change.⁸⁰

Both cases were appealed to the Texas Supreme Court.⁸¹ In the opening paragraph, the court put its finger on the issue: “The proper measure of damages is the controlling question presented here.”⁸² Here is how the court framed the issue:

Briefly, the contention of Morriss-Buick Company is, that the correct measure of damages was the difference, if any, between the value of what Pondrom parted with and what he

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.* at 267.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ See generally *Morriss-Buick Co. v. Pondrom*, 84 S.W.2d 272 (Tex. App.—Dallas 1935), *rev'd*, 113 S.W.2d 889 (Tex. [Comm’n Op.] 1938).

⁸⁰ *Id.* at 273.

⁸¹ See generally *Morriss-Buick v. Pondrom*, 113 S.W.2d 889 (Tex. [Comm’n Op.] 1938); *Morriss-Buick Co. v. Huss*, 113 S.W.2d 891 (Tex. [Comm’n Op.] 1938). Note how long this litigation was taking. The underlying events took place during 1929, yet the Dallas court’s opinions, which distinguished *George v. Hesse*, did not appear until 1935. The Commission of Appeals finally issued its opinions in 1938, and since the Supreme Court adopted those opinions, they are binding precedent from the Supreme Court of Texas.

⁸² *Pondrom*, 113 S.W.2d at 889.

received. The trial court assumed that Pondrom's secondhand automobile given in part exchange for the alleged new car was worth the value placed upon it in the trade by the parties, and used such value as a basis for the judgment, without submitting same as an issue to the jury.⁸³

The Texas Supreme Court stated that the question had led to a contrariety of opinion but that Texas law was settled by *George v. Hesse*:

This is the familiar rule announced by Judge Gaines in *George v. Hesse*, 100 Tex. 44, 93 S.W. 107, 8 L.R.A., N.S., 804, 123 Am.St.Rep. 772, 15 Ann.Cas. 456. It is here claimed that because the parties agree upon the value of Pondrom's automobile, the rule does not apply. We think the facts are not essentially different from those found in a multitude of similar cases where the George-Hesse rule has been applied.⁸⁴

The court followed with strong language reaffirming *George v. Hesse*: "After all there is nothing mysterious about a proper measure of damages, except the mystifying cases on the subject. The end desired is actual compensation for the injury—not profit."⁸⁵ It continued: "The true measure in every case of this kind is that rule which gives to the complaining party the actual amount of his loss resulting directly and proximately from the fraud practiced upon him."⁸⁶

Thus, *George v. Hesse* and *Morriss-Buick v. Pondrom* speak with a single voice: Texas law measures fraud damages by the out-of-pocket rule, not by the benefit-of-the-bargain rule.⁸⁷ If all of this attention to the invalidity of the benefit-of-the-bargain rule seems to belabor the point, that is probably because it does. But the point deserves some belaboring, inasmuch as modern courts may have forgotten it entirely.

During the years between the 1938 decision in *Pondrom* and the start of the great forgetfulness, the Texas Supreme Court repeated its recognition of the out-of-pocket rule on several occasions. First, in *Dallas Farm Machinery*

⁸³ *Id.* at 890.

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *See id.*; *Morriss-Buick Co. v. Huss*, 113 S.W.2d 891, 891 (Tex. [Comm'n Op.] 1938).

Company v. Reaves,⁸⁸ the court acknowledged the out-of-pocket rule in passing. Second, in *American Title Insurance Company v. Byrd*,⁸⁹ the plaintiff sought to escape the out-of-pocket rule by claiming statutory real estate fraud, but the court refused to let the plaintiff take advantage of the benefit-of-the-bargain measure, explaining instead that the transaction did not come within the statute. Finally, in 1971 the Texas Supreme Court backhandedly reaffirmed the traditional rule.⁹⁰ Using italics, the court noted that the benefit-of-the-bargain measure would be acceptable in cases under Article 4004, but the court held that Article 4004 “has no application to the facts of this case.”⁹¹

These expressions of support for the out-of-pocket rule can be downplayed as only oblique, but 1972 brought the Texas Supreme Court face to face with the issue. In *Sobel v. Jenkins*,⁹² the court reaffirmed the out-of-pocket rule outright and applied to the litigants. Fittingly, the case is another used car case. The plaintiff leased a Volkswagen that the defendant told him was new.⁹³ The plaintiff later found out that the Volkswagen was used.⁹⁴

The jury found for the plaintiff.⁹⁵ Unfortunately for everyone, the jury made findings only on the elements of the benefit-of-the-bargain rule.⁹⁶ Among other things, the jury found:

- (6) That the car would have been worth \$1250 at the time of the sale . . . if it had been new
- (7) That the car was actually worth \$400 at the time of the sale.⁹⁷

The case has a twisted procedural history, but a careful reading makes clear that the Texas Supreme Court stayed with the out-of-pocket rule.⁹⁸

⁸⁸ 307 S.W.2d 233, 241 (Tex. 1957).

⁸⁹ 384 S.W.2d 683, 685 (Tex. 1964).

⁹⁰ See *Stanfield v. O’Boyle*, 462 S.W.2d 270, 271 (Tex. 1971).

⁹¹ *Id.*

⁹² 477 S.W.2d 863, 868 (Tex. 1972).

⁹³ *Id.* at 864.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.* at 864–65.

⁹⁷ *Id.* at 865.

⁹⁸ *Id.* at 864.

After the verdict, the trial court granted the defendant a JNOV and sent the plaintiff away empty-handed.⁹⁹ It is difficult to discern the exact basis for the JNOV, but the trial court's reasoning makes no difference to the significance of the appeal.

The Waco Court of Civil Appeals affirmed.¹⁰⁰ The Waco court announced two theories for sending the plaintiff away with nothing. First, the Waco court relied on a preclusion theory arising from an earlier lawsuit.¹⁰¹ Second, the court relied on a no evidence theory aimed at the plaintiff's proof of liability.¹⁰² Since it was upholding the JNOV, the Waco court never had any reason to discuss the measure of damages.

By a unanimous vote, the Texas Supreme Court reversed the Waco court's decision and remanded for a new trial.¹⁰³ First, the court quickly rejected the preclusion theory as unsupported by the evidence.¹⁰⁴ Second, the court held that the plaintiff's proof of liability was sufficient.¹⁰⁵

Having destroyed the two bases for the Waco court's judgment, the Texas Supreme Court then faced the prospect of rendering judgment for the plaintiff on the verdict. But the defendant had brought forward a variety of alternate grounds for upholding the JNOV.¹⁰⁶ The Texas Supreme Court rejected most of those alternate grounds rapidly.¹⁰⁷ But then there came the following fall-back argument from the defendant, which the Texas Supreme Court spiced up with its own addition of italics: "The trial court correctly entered judgment for the [defendant] in disregard of the jury's answers to special issues nos. six, seven, eight and nine because there is no legally competent evidence to support the same and *For [sic] the further reason that the answers to said issues do not provide a determination of the proper elements of damage recoverable in a cause of action for fraud.*"¹⁰⁸

⁹⁹ *Id.* at 868.

¹⁰⁰ *Sobel v. Jenkins*, 468 S.W.2d 884, 888 (Tex. Civ. App.—Waco 1971), *rev'd*, 477 S.W.2d 863 (Tex. 1972).

¹⁰¹ *Id.* at 887.

¹⁰² *Id.* at 887–88.

¹⁰³ *Sobel*, 477 S.W.2d at 868.

¹⁰⁴ *Id.* at 865.

¹⁰⁵ *Id.* at 867.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at 867.

Recall that the jury had found the value of the car as represented, which is part of the benefit-of-the-bargain measure. The Texas Supreme Court explained that benefit-of-the-bargain was flatly out of bounds:

The correct measure of damages in this fraud action, as contended by [defendant], is the difference between the amount actually paid by [plaintiff] for the automobile and the fair market value of the automobile as delivered. *Morriss-Buick Co. v. Pondrom*, 131 Tex. 98, 113 S.W.2d 889 (1938). The jury's answers to Special Issues 6 and 7 would, if given effect, authorize recovery by [plaintiff] of the difference between the actual value of the car at the time of the sale and the value it would have had at such time if it had been new as represented. A recovery on that basis does not conform to the Texas rule of damages as set out in the *Pondrom* case. Both parties treat this action as one in fraud and not one for breach of warranty under the Tex. Bus. and Com. Code, §§ 2.313 and 2.714, V.T.C.A. Judgment cannot be rendered for [plaintiff] for the damages found by the jury in answer to issues 6, 7 and 9.¹⁰⁹

The court then decided to order a new trial in the interest of justice, rather than render against a plaintiff who had tried the case on the wrong theory.¹¹⁰

With *Sobel v. Jenkins* in mind, let us review the out-of-pocket rule's history in Texas. As of 1972, the Texas Supreme Court was saying unanimously that out-of-pocket was right, and benefit-of-the-bargain was wrong.¹¹¹ In fact, the Texas Supreme Court had been saying that for the better part of a century. The court had never wavered from *George v. Hesse* or *Morriss-Buick v. Pondrom*. Indeed, there had never even been a single vote from any Justice of the Texas Supreme Court suggesting that benefit-of-the-bargain could be proper in a case of common-law fraud.

But as *Sobel v. Jenkins* went into the books, the Texas Supreme Court went on to other things. The court simply stopped talking about the measure of damages for common-law fraud. Perhaps the court thought it had said everything that needed to be said. Perhaps the court thought there were more

¹⁰⁹*Id.* at 868.

¹¹⁰*Id.*

¹¹¹*See* *Dallas Farm Mach. Co. v. Reaves*, 307 S.W.2d 233, 241 (Tex. 1957); *see also* *Am. Title Ins. Co. v. Byrd*, 384 S.W.2d 683, 685 (Tex. 1964).

pressing issues to address. After all, courts of last resort should not have to spend limited resources merely repeating themselves on old topics. At any rate, the early 1970s brought something new that truly did require the Texas Supreme Court's attention: the DTPA.

B. After 1972: DTPA “misrepresentation” cases blur the force of the out-of-pocket measure for fraud.

The DTPA brought a revolution in commercial litigation. That revolution matters because it eclipsed a century of fraud law and allowed a generation of judges to forget about the traditional cases—such as *George v. Hesse*, *Morriss-Buick v. Pondrom*, and *Sobel v. Jenkins*—and the out-of-pocket rule that they laid down.

The DTPA expanded the rights and remedies for plaintiffs by allowing for attorneys' fees and treble damages.¹¹² The DTPA also allowed virtually no common-law defenses.¹¹³ It outlawed various kinds of representations, thereby overlapping with fraud and giving plaintiffs such a powerful weapon that garden-variety fraud seemed much less attractive by comparison.¹¹⁴ Why sue for fraud if a DTPA claim is available?

Plaintiffs flocked to the DTPA. The Texas Supreme Court followed along and began spending a great deal of time on DTPA cases. At the same time, the court stopped saying much of anything about common law fraud. Perhaps the court thought there was nothing new to say after seventy-five years of consistently endorsing the out-of-pocket rule.¹¹⁵

Today's trouble with the measure of damages for fraud is directly traceable to two facts. First, the Texas Supreme Court remained silent on the issue during the DTPA era, allowing a layer of dust to settle on *George v. Hesse* and its progeny. Second, judges began to use increasingly imprecise language in their opinions on the issue of damage measures under the DTPA.

Although the Texas Legislature modified the DTPA's treatment of actual damages in 1995, what matters is the pre-1995 version of the DTPA. The pre-1995 version of the DTPA allowed a plaintiff to recover “actual damages”

¹¹²TEX. BUS. & COM. CODE ANN. §§ 17.50(b)(1), 17.555.

¹¹³See *Alvarado v. Bolton*, 749 S.W.2d 47, 48 (Tex. 1988).

¹¹⁴*Id.*

¹¹⁵See Gaddy Wells, Note, *Measure of Damages for Misrepresentation under the Texas Deceptive Trade Practices Act*, 29 BAYLOR L. REV. 135, 137 (1977) (recognizing that the out-of-pocket rule continued to apply to fraud cases after passage of the DTPA).

but did not define how “actual damages” were to be measured.¹¹⁶ The statute could surely have been drafted to specify whether a plaintiff could recover benefit-of-the-bargain damages. But the legislature left that matter to the courts. Faced with the task of giving meaning to the phrase “actual damages,” the Texas Supreme Court held that the DTPA permits a plaintiff to recover so-called common law damages: “Actual damages means those recoverable at common law.”¹¹⁷

During this period, the Waco Court of Civil Appeals came out with some innocent and accurate remarks about Texas having two different measures of damage for “misrepresentation.” In *Johnson v. Willis*,¹¹⁸ the plaintiff had sued for misrepresentation.¹¹⁹ The Waco court correctly noted the DTPA’s failure to define “actual damages.”¹²⁰ The court therefore looked to the common law to find the appropriate measure of damages.¹²¹ The court then listed two distinct kinds of misrepresentations: fraud-based and warranty-based. The court explained:

In common law tort actions for fraudulent misrepresentations, Texas courts have adopted the “out of pocket” rule for measuring general damages, i.e., general damages are measured by the difference between the price paid (or the value parted with) and the value received. On the other hand, in actions brought for misrepresentations which are in the nature of breaches of warranty, Texas courts have applied the “loss of bargain” rule for measuring general damages, i.e. general damages are measured by the difference between the value of the goods as warranted and the value as received.¹²²

There is nothing wrong with what the Waco court said. In fact, the court described Texas law correctly. The court plainly recognized that fraud

¹¹⁶Deceptive Trade Practices—Consumer Protection—Waiver, Damages, Notice, and Settlement Offer, 71st Leg., R.S., S.B. No. 437, § 17.50, 1989 Tex. Sess. Law Serv. 380.

¹¹⁷*Brown v. Am. Transfer & Storage Co.*, 601 S.W.2d 931, 939 (Tex. 1980).

¹¹⁸596 S.W.2d 256 (Tex. App.—Waco 1980, writ ref’d n.r.e.).

¹¹⁹*Id.* at 257.

¹²⁰*Id.* at 262.

¹²¹*Id.*

¹²²*Id.* at 262–63.

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damages were limited by the out-of-pocket rule and that contractual (or warranty) damages were not.¹²³

The Waco court's remarks surfaced with approval in a 1984 Texas Supreme Court decision involving the DTPA. There, the Texas Supreme Court announced that there were two measures of damages for "misrepresentation," and that a DTPA plaintiff can pick either one. The court's exact words deserve quoting:

Texas courts have recognized two measures of damages for misrepresentation. Texas common law allows an injured party to recover the actual injury suffered measured by "the difference between the value of that which he has parted with, and the value of that which he has received." *George v. Hesse*, 100 Tex. 44, 93 S.W. 107 (1906). This measure of damages is known as the "out of pocket" measure and is calculated as of the time of sale. W. PROSSER, HANDBOOK OF THE LAW OF TORTS, § 110 (4th ed. 1971). The second remedy available in Texas, known as the "benefit of the bargain" measure, allows the plaintiff to recover the difference between the value as represented and the actual value received. *Johnson v. Willis*, 596 S.W.2d 256, 262 (Tex. Civ. App.—Waco), writ *ref'd n.r.e. per curiam*, 603 S.W.2d 828 (Tex. 1980). The DTPA permits a plaintiff to recover under either the "out of pocket" rule or the "benefit of the bargain" rule, whichever gives the consumer the greater recovery.¹²⁴

Any reader who had been studying *George v. Hesse* and the history of the out-of-pocket rule would have known that the Texas Supreme Court was right. The proper common-law measure depended on preserving the distinction between tort and contract, i.e., the difference between fraudulent misrepresentation and warranty-based misrepresentation.

Leyendecker did not overrule *George* and hardly offered an opportunity for doing so, because *Leyendecker* was a DTPA case rather than a fraud case.¹²⁵ Unfortunately, lawyers and judges suddenly lost sight of the

¹²³*Id.* When Texas adopted the Uniform Commercial Code in 1967, it also adopted the warranty remedies of Article 2, including benefit-of-the-bargain damages for cases involving the sale of goods. TEX. BUS. & COM. CODE ANN. § 2.714.

¹²⁴*Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984).

¹²⁵*Id.* at 371.

distinction between tort and contract, a distinction that was understood (but not stressed) by the Waco court in *Johnson v. Willis* and by the Texas Supreme Court in *Leyendecker*.

According to one observer, “opinions on remedies for fraudulent inducement surged in the early 1980s as the effects of the DTPA began to filter through the system.”¹²⁶ The courts began announcing that the plaintiff was entitled to recover the benefit-of-the-bargain in cases of common-law fraud.¹²⁷ The error started to snowball.¹²⁸ By the 1990s, courts of appeals had stopped following *George* and started citing *Leyendecker* for the proposition that the plaintiff gets to choose either out-of-pocket or benefit-of-the-bargain.¹²⁹

The Texas Supreme Court had little opportunity to fix the problem, perhaps because few appellate lawyers were pushing the issue. Most cases to make it to the Texas Supreme Court’s docket involved the DTPA, where lawyers could accurately say that the plaintiff gets a choice between damage measures. But the DTPA discussion in *Leyendecker* was warping the law of fraud. In a DTPA case called *Bankston Nissan*, the Texas Supreme Court found no evidence of damages.¹³⁰ The court’s actual holding was that the plaintiff proved neither out-of-pocket damages nor benefit-of-the-bargain damages.¹³¹ But note how the discussion of the measure of damages seems

¹²⁶George P. Roach, *Measuring Business Damages in Fraudulent Inducement Cases*, 11 HOUS. BUS. & TAX L.J. 1, 17 (2011).

¹²⁷*E.g.*, *Woodyard v. Hunt*, 695 S.W.2d 730, 732 (Tex. App.—Houston [1st Dist.] 1985, no writ); *see New Process Steel Corp. Inc. v. Steel Corp. of Tex., Inc.*, 703 S.W.2d 209, 215 (Tex. App.—Houston [1st Dist.] 1985, writ ref’d n.r.e.) (“Where a contract is breached through the fraud of one of the parties, the measure of damages is the amount required to compensate the other party for his loss of the benefit of the bargain.”).

¹²⁸*E.g.*, *Airborne Freight Corp., Inc. v. C.R. Lee Enters., Inc.*, 847 S.W.2d 289, 295 (Tex. App.—El Paso 1992, writ denied).

¹²⁹*See Streller v. Hecht*, 859 S.W.2d 114, 116 (Tex. App.—Houston [14th Dist.] 1993, writ denied) (“Our common law allows recovery of either the benefit of the bargain measure of damages or out of pocket losses in fraud claims.”) (citing *Leyendecker*, 683 S.W.2d at 369); *Matthews v. AmWest Sav. Ass’n*, 825 S.W.2d 552, 554 (Tex. App.—Beaumont 1992, writ denied) (“Common law allows two measures of recovery for fraudulent misrepresentations: (1) the ‘out of pocket’ difference between the value of that parted with and that received, or (2) the ‘benefit of the bargain’ difference between the value as represented and the value received.”) (citing *Leyendecker*, 683 S.W.2d at 369).

¹³⁰*W.O. Bankston Nissan, Inc. v. Walters*, 754 S.W.2d 127, 128 (Tex. 1988).

¹³¹*Id.*

to drift away from the tort versus contract distinction that lay beneath *Leyendecker* and the Waco court's opinion in *Johnson v. Willis*:

The dispositive issue in this case is the correct measure of damages. In a DTPA case, the plaintiff is entitled to actual damages. Tex. Bus. & Comm. Code § 17.50(b)(1). This court has defined actual damages as those recoverable at common law. *Farrell v. Hunt*, 714 S.W.2d 298, 300 (Tex. 1986); *Brown v. American Transfer & Storage Co.*, 601 S.W.2d 931, 939 (Tex. 1980). Under common law, there are two measures of damages for misrepresentation: (1) the “out of pocket” measure, which is the “difference between the value of that which was parted with and the value of that which was received”; and (2) the “benefit of the bargain” measure, which is the difference between the value as represented and the value actually received. The DTPA permits a plaintiff to recover either the “out of pocket” or the “benefit of the bargain” damages, whichever is greater. *Leyendecker & Associates, Inc. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984); *Sobel v. Jenkins*, 477 S.W.2d 863 (Tex. 1972); *Chrysler Corp. v. Schuenemann*, 618 S.W.2d 799, 805 (Tex. Civ. App.—Houston [1st Dist.] 1981, writ ref'd n.r.e.); *Smith v. Kinslow*, 598 S.W.2d 910, 912 (Tex. Civ. App.—Dallas 1980, no writ); *Jack Criswell Lincoln-Mercury, Inc. v. Haith*, 590 S.W.2d 616 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.). See, *Vista Chevrolet, Inc. v. Lewis*, 709 S.W.2d 176 (Tex. 1986).¹³²

Even though the court was not intending to expand the measure of damages for common law fraud, a careless reader might have missed the distinction between fraud and contract damages.¹³³

Some members of the court felt the need to speak directly to the law of damages under the DTPA. A concurring opinion commented on the classic distinction between direct damages and consequential damages:

¹³² *Id.*

¹³³ When confronted with a later argument based on certain remarks in *Bankston Nissan*, the Supreme Court defended *Bankston Nissan* strictly as a sufficiency case, not a measure of damage case at all. See *Spencer v. Eagle Star Ins. Co. of Am.*, 876 S.W.2d 154, 158 (Tex. 1994) (“The Court concluded first, however, that plaintiff had failed to meet his burden of proof, by showing his losses under either measure of damages.”).

For misrepresentation, there are two recognized measures of direct damages. The “out of pocket” measure, which operates on a restitutionary theory, measures the difference between the value of that which was parted with and the value of that which was received. The “benefit of the bargain” measure, which utilizes an expectancy theory, evaluates the difference between the value as represented and the value actually received. *W.O. Bankston Nissan*, 754 S.W.2d at 128; *Leyendecker & Assoc. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984). See Dan B. Dobbs, *The Law of Remedies* § 9.2 (1973); J.F. Rydstrom, Annotation, “Out of Pocket” or “Benefit of Bargain” as Proper Rule of Damages for Fraudulent Representations Inducing Contract for the Transfer of Property, 13 A.L.R.3d 875 (1967). The DTPA allows the injured consumer to recover either the “out of pocket” measure or the “benefit of the bargain” measure of damages, whichever is greater. *W.O. Bankston Nissan*, 754 S.W.2d at 128.¹³⁴

There is nothing objectionable about these statements. But a careless reader might miss the difference between “misrepresentation” and common-law fraud, thereby mistakenly concluding that fraud triggers the benefit-of-the-bargain measure.

In *Johnson & Johnson Medical, Inc. v. Sanchez*, the defendant managed to get review granted on a point urging the Texas Supreme Court to reject the benefit-of-the-bargain measure.¹³⁵ But the defendant ended up prevailing on another ground, so the court never discussed the issue.¹³⁶

In *Tilton v. Marshall*, a concurring opinion fell headlong into the trap of reading *Leyendecker* as legalizing the benefit-of-the-bargain measure for common law fraud:

Damages recoverable for fraud are compensatory, consequential and punitive. Compensatory damages are measured two ways: either as the difference between the value given by the plaintiff and the value received, called “out-of-pocket” damages, or as the difference between the

¹³⁴*Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 163 (Tex. 1992) (Phillips, C.J., concurring).

¹³⁵*Johnson & Johnson Med., Inc. v. Sanchez*, 924 S.W.2d 925, 927 (Tex. 1996).

¹³⁶*Id.* at 929–30.

value promised and the value received, called “benefit-of-the-bargain” damages. *Leyendecker & Assocs. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984).¹³⁷

Although the discussion would have been dictum even if the concurrence had been the opinion of the majority, the point is simply that *Leyendecker* was leading to serious misunderstandings.

In 1997, the court again flirted with the mistaken conclusion that a fraud plaintiff can recover benefit-of-the-bargain damages. Predictably, the case was a DTPA case that relied on *Leyendecker*:

Under Texas common law, direct damages for misrepresentation are measured in two ways. *W.O. Bankston Nissan, Inc. v. Walters*, 754 S.W.2d 127, 128 (Tex. 1988); *Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984). Out-of-pocket damages measure the difference between the value the buyer has paid and the value of what he has received; benefit-of-the-bargain damages measure the difference between the value as represented and the value received. *Leyendecker*, 683 S.W.2d at 373. Under the DTPA, a plaintiff may recover under the damage theory that provides the greater recovery. *Id.* Both measures of damages are determined at the time of sale.¹³⁸

As noted, the case involved only the DTPA, so no one can say that the true holding deviated from a century of law banning the benefit-of-the-bargain measure. Still, the language might let an uninformed reader think so.

In sum, during the DTPA-dominated years from 1973 to 1997 the Texas Supreme Court never rejected the out-of-pocket rule of *George v. Hesse*, but neither did the court do much to reaffirm the rule. Instead, the court allowed plaintiffs to recover benefit-of-the-bargain damages in cases of DTPA “misrepresentation.” But the tidal forces of the DTPA cases (especially *Leyendecker*) were fated to reshape common law fraud litigation. Thus the stage became set for the great forgetfulness.

¹³⁷*Tilton v. Marshall*, 925 S.W.2d 672, 693 (Tex. 1996) (Hecht, J., concurring).

¹³⁸*Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 817 (Tex. 1997).

II. THE STATE OF THE MEASURE IS BACK AT A CROSSROADS

Some of the “confusion” surrounding the measure of damages for fraud stems from the continued confusion about the difficult area of the law known as “contorts.”¹³⁹ When the correct contours of that area are established, the resulting clarity should lead directly to the proper measure of damages. Unfortunately, as part of a notable decision that helpfully delineated the boundaries between fraud and contract liability, some uncertainty crept inadvertently into the law relating to the measure of damages.¹⁴⁰

A. *The Rise of the Contort Problem*

For our purposes, the contort problem began with allegations that a party had negligently performed a contract.¹⁴¹ Rather than hold that the nature of the injury determined the type of claim, the Texas Supreme Court stated, perhaps overbroadly, that if a party has to prove the terms of the contract in order to recover, then all he has is a claim for breach of contract.¹⁴² This holding seems overbroad because the terms of the contract may be necessary to give rise to the legal duty that usually sounds in tort. For instance, a worker injured by an independent contractor may want to prove the terms of the contract. Even a worker suing his employer for workers’ compensation may have to prove he was employed by the employer, which may require proof of the terms of the contract. What the court may have meant to say was when the duty existed solely by virtue of the contract, there was no claim in tort.

The next year gave it that opportunity.¹⁴³ When the negligent performance of a contract to repair a water heater resulted in a fire that burned down the entire house, the Texas Supreme Court held the defendant liable in tort by

¹³⁹ See Roach, *supra* note 126, at 73 (“[S]ome appellate opinions manifest significant confusion on these issues among the judiciary . . .”); see also *G.T. Leach Builders, LLC v. Sapphire V.P., LP*, 458 S.W.3d 502, 530 (Tex. 2015) (“This argument raises a complex legal doctrine: the ‘economic loss’ rule, sometimes referred to in this context as the law of ‘contorts.’”); William Powers, Jr., *The Availability of Tort Remedies for Breach of Contract: Border Wars*, 72 TEX. L. REV. 1209, 1215 (1994).

¹⁴⁰ The discussion of the measure of damages was unnecessary to the outcome because neither party raised the issue before the Supreme Court, doubtless because the petitioner correctly saw a path to victory based on disputing the sufficiency of the evidence. See *Formosa Plastics Corp. v. Presidio Eng’rs & Constructors, Inc.*, 960 S.W.2d 41, 49 (Tex. 1998) (dictum).

¹⁴¹ *Int’l Printing Pressman & Assistants Union of N. Am. v. Smith*, 198 S.W.2d 729, 735 (Tex. 1946).

¹⁴² *Id.*

¹⁴³ *Montgomery Ward & Co. v. Scharrenbeck*, 204 S.W.2d 508, 510 (Tex. 1947).

implying a legal duty not to act negligently in a way that injures another person or his property.¹⁴⁴ This duty was imposed on top of the implied contractual duty to perform in good faith, in a workmanlike manner, and with reasonable skill and care.¹⁴⁵ Because the duty not to negligently injure another person or his property exists at law, irrespective of any contractual duties, the court found the conduct tortious.¹⁴⁶

The legal problem was to distinguish situations involving the negligent performance of a contract that had not injured persons or property. At least two rules were possible. First, the court could have said that an injury between contracting parties is always a contractual claim. Tort law, by contrast, would apply to injuries between non-contracting parties. In part, this rule would have resurrected the old forms of action between *assumpsit*, *trespass*, and *trespass on the case*.

Another possibility was to describe a “tort event” as one presenting the risk of personal injuries or property damage. While they may also result in economic losses, such as lost earnings or profits, the underlying event simply looks like a tort, because it imposes the risk of physical injury to persons and property. If there was not a tort event, then any claim would fall under some other legal doctrine.

The logic from these cases was tested in *Nobility Homes Inc. v. Shivers*.¹⁴⁷ Faced with defects in the product that had not caused an injury to person or property, the court held that, because (1) the defects did not render the product unreasonably dangerous, and (2) the loss was solely economic, the claim did not sound in tort.¹⁴⁸ Instead, the dissatisfied consumer had a breach of warranty claim under the Uniform Commercial Code.¹⁴⁹ This was an excellent synthesis of the correct rule for distinguishing tort claims.

But the waters muddied a year later in *Mid-Continent Aircraft Corp. v. Curry County Spraying Service, Inc.*¹⁵⁰ There, the Texas Supreme Court faced an airplane crash.¹⁵¹ The party sued under strict liability based on a defective bolt that had caused the crash.¹⁵² The Texas Supreme Court held

¹⁴⁴ *Id.* at 510–11.

¹⁴⁵ *Id.* at 510.

¹⁴⁶ *Id.*

¹⁴⁷ *See* 557 S.W.2d 77 (Tex. 1977).

¹⁴⁸ *Id.* at 78.

¹⁴⁹ *Id.*

¹⁵⁰ *See* 572 S.W.2d 308 (Tex. 1978).

¹⁵¹ *Id.* at 310.

¹⁵² *Id.*

that the claim did not sound in tort, because the only damage was economic loss to the airplane itself.¹⁵³ The court relegated the plaintiff to the Uniform Commercial Code remedy.¹⁵⁴ Although recognizing that this defect made the airplane unreasonably dangerous, the majority ignored dissenting Justice Pope's reliance on the court's reasoning in *Nobility Homes* that an unreasonably dangerous product should lead to a recovery in tort, since it risked physical injury to persons and property.¹⁵⁵

On the same day, however, the Texas Supreme Court reached a different result in *Signal Oil & Gas Co. v. Universal Oil Products*.¹⁵⁶ The court reasoned that a tort event had occurred, since the defective product had caused not only its own destruction, but also a fire that had damaged adjoining property.¹⁵⁷ The court also permitted a recovery under the UCC. But as Justice Pope's concurrence pointed out, damage to other property was now a tort, but damage to the product itself was not.¹⁵⁸ He argued that the majority's reasoning in *Signal Oil* should have caused a different result in *Mid Continent Aircraft*, since the defective bolt had caused injury to other property—the airplane itself and the cargo on board.¹⁵⁹

A few years later, the Texas Supreme Court faced breach of warranty and gross negligence claims for a house that had not been built to representations.¹⁶⁰ The defects did not render the house unreasonably dangerous, and there had been no physical injuries.¹⁶¹ The Texas Supreme Court held that punitive damages were unavailable because no tort claim was stated.¹⁶² Using the old *International Printing* test, the court held that the substance of the claim, not the pleading, controlled.¹⁶³ In essence, the plaintiff sued because the house he was promised was not the house he received.¹⁶⁴ Because this depended solely on the contractual promise, there was no tort

¹⁵³ *Id.* at 313.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* at 311.

¹⁵⁶ 572 S.W.2d 320, 325 (Tex. 1978).

¹⁵⁷ *Id.*

¹⁵⁸ *Id.* at 333.

¹⁵⁹ *Id.* at 332.

¹⁶⁰ *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 617 (Tex. 1986).

¹⁶¹ *Id.* at 618.

¹⁶² *Id.*

¹⁶³ *Id.* at 617–18.

¹⁶⁴ *Id.* at 618.

claim.¹⁶⁵ The court also borrowed from the *Nobility Homes* test to distinguish torts from contracts: when the injury was said to be merely an economic loss to the subject matter of the contract, there was no tort.¹⁶⁶ Without a distinct tort injury and damages caused by it, a party could not recover punitive damages.¹⁶⁷

Given the logic of these cases, a defendant ultimately argued that a claim for tortious interference with contract sounded in contract, not tort, since the only damage concerned an economic loss to the subject matter of the contract.¹⁶⁸ The Texas Supreme Court rejected that argument in *American Nat'l Petroleum Co. v. Transcontinental Gas Pipe Line Corp.*¹⁶⁹ The court recognized that commercial torts often involve only economic losses.¹⁷⁰ This, of course, is circular reasoning. It could have been used to justify an opposite outcome in *Nobility Homes*, since the question is when is there a tort. The court could have chosen to reason that the injury to the other contract was similar to the fire that had damaged other property in *Signal Oil*. In any event, the opinion is of limited precedential value because it is based on a deemed finding of separate actual damages due to a waiver of the right to object—in fact, there had been a stipulation of tort damages.

The next challenge was presented in *Southwestern Bell Tel. Co. v. DeLanney*.¹⁷¹ The court confronted a negligent failure to run an advertisement in the Yellow Pages.¹⁷² Was this a mere breach of contract, or negligence? The court decided it was merely a breach of contract.¹⁷³ Since there had been no risk of personal injury or property damage, no tort duty was implicated.¹⁷⁴ The only duty arose from the contract.¹⁷⁵ Furthermore, the loss was only the benefit-of-the-bargain of the contract, which was an economic loss to the subject matter of the contract.¹⁷⁶

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Am. Nat'l Petroleum Co. v. Transcon. Gas Pipe Line Corp.*, 798 S.W.2d 274, 279 (Tex. 1990).

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 278.

¹⁷¹ *See* 809 S.W.2d 493 (Tex. 1991).

¹⁷² *Id.* at 493.

¹⁷³ *Id.* at 495.

¹⁷⁴ *Id.* at 494–95.

¹⁷⁵ *Id.* at 495.

¹⁷⁶ *Id.*

In 1996 came a case at the intersection between the DTPA and contract.¹⁷⁷ Ace Sign, Inc. had simply failed to perform its contractual promise.¹⁷⁸ The court held that this was merely a breach of contract, not a deceptive trade practice.¹⁷⁹ The court reasoned that the damages were caused solely by the failure to run the advertisement, which was the breach of contract.¹⁸⁰ The representations that the advertisement would be run did not cause the lost profits damages.¹⁸¹ True enough, but those representations might have induced Crawford to pay Ace to run the advertisement.¹⁸² That payment would be damages caused by the representations.¹⁸³ Therefore, at bottom, this analysis seems somewhat circular. The opinion also states that permitting the failure to perform a contractual promise into a DTPA action would make almost every breach of contract case also a DTPA case.¹⁸⁴ Again, that seems circular. The question is whether this is already a DTPA case. And the reasoning even seems open to question, since the DTPA says that its remedies are cumulative to those at common law.¹⁸⁵

The case is odd. Consider this hypothetical: A pays B to buy a red 1998 Pontiac. B delivers a blue 1998 Pontiac. Is the color a bargained-for promise, so that there has been a breach of contract? Or is B's promise only to deliver a car, so that its color is merely a representation of its character? There is no way to be sure, absent an express written agreement or admissions of the parties about their intentions. But if it is only the latter, then A cannot sue for breach of contract, but should have a DTPA claim. Yet, looked at another way, A's only damages would have been caused by B's failure to perform the contractual promise to deliver a red car.

It may be that the court is trying to articulate a rule similar to the one in *Signal Oil*. If the only injury is to the contractual promise itself, then there is no extra-contractual liability, such as tort or DTPA. But if there is a misrepresentation distinct from the contractual promises, then it is analogous to an injury to other property, which would be a tort. This problem was only aggravated in the fraud context.

¹⁷⁷ *Crawford v. Ace Sign, Inc.*, 917 S.W.2d 12, 12 (Tex. 1996) (per curiam).

¹⁷⁸ *Id.* at 14.

¹⁷⁹ *Id.* at 14–15.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.* at 14.

¹⁸³ *See id.* at 14–15.

¹⁸⁴ *Id.* at 14.

¹⁸⁵ TEX. BUS. & COM. CODE ANN. § 17.43.

Defendants in fraud cases had been arguing that certain kinds of acts that were labeled “fraud” were not tortious at all but rather contractual.¹⁸⁶ The defense argument often came up in the context of the statute of frauds.¹⁸⁷ D would base his argument on the following propositions: (1) benefit-of-the-bargain damages are recoverable in a contract case but not in a fraud case, (2) P is suing for benefit-of-the-bargain damages, (3) P’s true cause of action is not for fraud but for breach of contract, (4) P’s cause of action is subject to the statute of frauds.¹⁸⁸ In other words, D would urge the court to analyze P’s cause of action based on its substance rather than its form.¹⁸⁹

The form-over-substance approach would seem to be quite powerful. Pleadings are to be understood according to their contents, not their labels.¹⁹⁰ If a plaintiff puts the caption “fraud” on a pleading that alleges breach of contract, the pleading remains a contract cause of action just the same.¹⁹¹ So in cases of oral dealings, the outcome could turn on deciding whether a claim was truly for breach of contract or for fraud, because the statute of frauds could bar enforcement of oral contracts.

How then does one go about deciding whether a cause of action called “fraud” is really a cause of action for breach of contract? The most obvious way is to look at the measure of damages. If the plaintiff wants benefit-of-the-bargain damages—that is, if he seeks nothing more than enforcement of a false oral promise—then the cause of action sounds in contract. Genuine fraud claims remain undisturbed, on the understanding that they trigger the traditional rule restricting direct damages to out-of-pocket losses.

Using this analysis, the courts began the task of separating tort claims from contract claims.¹⁹² In 1964, *Wade v. State Nat’l Bank* held that a plaintiff’s fraud claim was barred by the statute of frauds where a recovery

¹⁸⁶*Formosa Plastics Corp. USA v. Presidio Eng’rs. & Contractors Inc.*, 960 S.W.2d 41, 46 (Tex. 1998).

¹⁸⁷*See Haase v. Glazner*, 62 S.W.3d 795, 798 (Tex. 2001).

¹⁸⁸*See id.* at 799.

¹⁸⁹*See TEX. R. CIV. P. 71; see also State Bar of Tex. v. Heard*, 603 S.W.2d 829, 833 (Tex. 1980).

¹⁹⁰*See Heard*, 603 S.W.2d at 833 (“We look to the substance of a plea for relief to determine the nature of the pleading, not merely at the form of title given to it.”).

¹⁹¹As every farmer knows, “a duck which is called a horse does not become a horse; a duck is a duck.” *City of Corpus Christi v. Bayfront Assocs., Ltd.*, 814 S.W.2d 98, 109 n.4 (Tex. App.—Corpus Christi 1991, writ denied).

¹⁹²*Wade v. State Nat’l Bank*, 379 S.W.2d 717, 719 (Tex. App.—El Paso 1964, writ ref’d n.r.e.).

would be the equivalent of enforcing the oral promise, reasoning that a plaintiff cannot do indirectly what the law blocks him from doing directly.¹⁹³

But the most influential modern decision is *Collins v. McCombs*.¹⁹⁴ Writing for the court, Justice Cadena introduced the issue by noting that “the cases bearing directly on the question of whether the statute prevents an action for fraud or deceit based upon an oral false promise within the statute are relatively few, and the courts considering the problem have reached different results.”¹⁹⁵ To illustrate the point, he noted the Texas Supreme Court’s holding in *Sibley v. Southland Life Ins. Co.* that oral fraud is still actionable.¹⁹⁶ Then he noted the seemingly inconsistent holding in *Wade v. State Nat’l Bank* “that there could be no action for fraud based on a contract declared unenforceable by the statute of frauds, because to allow recovery in such a case ‘would be to create an anomaly [sic], and allow one to do indirectly what he could not by law do directly.’”¹⁹⁷

Justice Cadena then resolved the contort question by analyzing the plea for damages, with *George v. Hesse* serving as the litmus test for true fraud damages:

We do not consider the *Sibley* and *Wade* formulations of the general rule to be necessarily in conflict. Even if it be conceded that an action in tort for deceit is unaffected by the provisions of the statute of frauds, the judicial disregard of the statute should be limited to situations in which the essence of the action truly sounds in tort. Where plaintiff, although casting his complaint in the form of a cause of action for fraud, is attempting to recover damages for the breach of the promise, it is clear that he is, in effect, attempting to enforce the oral agreement. Where, as here, plaintiff is seeking to recover what he would have gained had the promise been performed, it is evident that the gist of his cause of action is the breach of the unenforceable promise. At least since the decision in *George v. Hesse*, 100 Tex. 44, 93 S.W. 107 (1906), it has been settled that, except in cases of fraud related to transactions in real estate, the measure of

¹⁹³ *Id.*

¹⁹⁴ See 511 S.W.2d 745 (Tex. App.—San Antonio 1974, writ ref’d n.r.e.).

¹⁹⁵ *Id.* at 747.

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

damages for fraud and deceit is not what the plaintiff might have gained, had the representation been true, but what he has lost. Since plaintiff is here seeking to recover what he would have gained had the promise been performed, it is apparent that his action, while cast in language sounding in tort, is an indirect attempt to recover for the breach of the unenforceable promise and is, therefore, barred by the statute of frauds.¹⁹⁸

For all the ink that has been spilled on the contort issue since then, no one has ever improved on Justice Cadena's analysis. Indeed, most courts after *Collins* adopted its approach wholesale.¹⁹⁹ But this view was not unanimous.²⁰⁰ For instance, in *Hastings v. Houston Shell & Concrete*,²⁰¹ the court announced, albeit unpersuasively, that the 1964 decision in *Wade* "conflicts" with *Sibley*.²⁰² The court therefore held that the statute of frauds was inapplicable to the plaintiff's cause of action for fraud.²⁰³

By the 1990s, the contort problem was being called "problematic"²⁰⁴ and "a muddy area, devoid of bright line rules or easy answers as to what conduct constitutes a tort, and what a breach of contract."²⁰⁵ Even among the courts

¹⁹⁸ *Id.* at 747 (footnote omitted).

¹⁹⁹ *E.g.*, *Weakly v. East*, 900 S.W.2d 755, 759 (Tex. App.—Corpus Christi 1995, writ denied); *Leach v. Conoco, Inc.*, 892 S.W.2d 954, 959 (Tex. App.—Houston [1st Dist.] 1995, writ dismissed w.o.j.); *Gold Kist, Inc. v. Carr*, 886 S.W.2d 425, 432 (Tex. App.—Eastland 1994, writ denied); *Collins v. Allied Pharmacy Mgmt., Inc.*, 871 S.W.2d 929, 936 (Tex. App.—Houston [14th Dist.] 1994, no writ); *Barbouti v. Munden*, 866 S.W.2d 288, 293–94 (Tex. App.—Houston [14th Dist.] 1993, writ denied); *Webber v. M.W. Kellogg Co.*, 720 S.W.2d 124, 129 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.); *Keriotis v. Lombardo Rental Tr.*, 607 S.W.2d 44, 45 (Tex. App.—Beaumont 1980, writ ref'd n.r.e.); *Benoit v. Polysar Gulf Coast, Inc.*, 728 S.W.2d 403, 408 (Tex. App.—Beaumont 1987, writ ref'd n.r.e.).

²⁰⁰ *E.g.*, *Hastings v. Houston Shell & Concrete*, 596 S.W.2d 142, 144 (Tex. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.).

²⁰¹ *Id.*

²⁰² *Id.*

²⁰³ *Id.* To the extent that the *Hastings* court thought that the statute of frauds had no application to a claim for statutory stock fraud or statutory real estate fraud, there is Supreme Court authority to the contrary. *See Douglass v. Texas-Canadian Oil Corp.*, 174 S.W.2d 730, 731 (Tex. 1943) (rejecting a claim of statutory fraud as barred by the statute of frauds).

²⁰⁴ *Peco Constr. Co. v. Guajardo*, 919 S.W.2d 736, 738 (Tex. App.—San Antonio 1996, writ denied) (footnote omitted).

²⁰⁵ *Airborne Freight Corp., Inc. v. C.R. Lee Enters., Inc.*, 847 S.W.2d 289, 293 (Tex. App.—El Paso 1992, writ denied).

that favored the approach taken by Justice Cadena in *Collins*, there was less than perfect harmony. One of Justice Cadena's distinguished successors commented on the disarray: "In the First and Fourteenth Courts of Appeals, it is now well established that a plaintiff who pleads a benefit-of-the-bargain measure of damages does not plead a cause of action sounding in tort; this rule applies even when the plaintiff pleads fraudulent inducement. In this court, on the other hand, the pleaded measure of damages is not dispositive of the contort issue."²⁰⁶

B. *Formosa Plastics*

With the bar now in the midst of the great forgetfulness, then came *Formosa*.²⁰⁷ There the court stated that fraud in the inducement, like the negligence in *Scharrenbeck*, implicated a duty outside the contract.²⁰⁸ Although there was no risk of personal injury (mental anguish excepted) or property damage in a fraud case, the law imposed a duty to refrain from lying to induce a party into a binding contract.²⁰⁹ Since this duty existed outside the contract, it was a tort duty.²¹⁰ Then, in dictum, the court said that simply because fraud and contract allowed the same measure of damages would not mean there was no tort.²¹¹ To gauge the full impact of the *Formosa* dictum, one must examine the case in some detail.

In *Formosa*, the jury had found for the plaintiff on three causes of action: breach of contract, fraud, and breach of the duty of good faith and fair dealing.²¹² The jury found actual damages and also awarded a large amount of punitive damages.²¹³ After a remittitur, the trial court rendered judgment for the plaintiff in the amount of \$700,000 in actual damages and \$10 million in punitive damages.²¹⁴ The court of appeals affirmed.²¹⁵

²⁰⁶Am. Nat'l Ins. Co. v. Int'l Bus. Machs. Corp., 933 S.W.2d 685, 690 (Tex. App.—San Antonio 1996, writ denied) (Duncan, J., concurring and dissenting) (citations omitted).

²⁰⁷See 960 S.W.2d 41 (Tex. 1998).

²⁰⁸*Id.* at 46.

²⁰⁹*Id.* at 47.

²¹⁰*Id.*

²¹¹*Id.*

²¹²*Id.* at 44.

²¹³*Id.*

²¹⁴*Id.*

²¹⁵*Id.*

Having lost below, the defendant Formosa needed to persuade the Texas Supreme Court to get rid of the \$10 million punitive damages award.²¹⁶ Formosa suggested two ways of doing that.²¹⁷

First, in a contort argument, Formosa argued that the contractual nature of the transaction should displace a claim for fraudulent inducement.²¹⁸ This argument analogized from the *DeLanney* rule that contract can displace negligence.²¹⁹ Winning this argument would not have eliminated the plaintiff's breach of contract recovery for \$700,000, but it would have made the \$10 million punitive damages award unrecoverable.

Second, in a fact-intensive challenge to the sufficiency of the damages proof, Formosa argued that there was no evidence to support the finding of \$700,000 in actual damages.²²⁰ Formosa chose not to make the *George v. Hesse* argument that benefit-of-the-bargain damages are unlawful in a fraud case.²²¹ Instead, it argued that the proof was insufficient no matter whether one used the out-of-pocket measure or the benefit-of-the-bargain measure.²²² The lack of a dispute over the damage measure is key to recognizing *Formosa's* remarks about the measure as dictum.

While the Texas Supreme Court rejected Formosa's contort argument, it accepted Formosa's sufficiency argument and found the plaintiff's recovery unsustainable.²²³ In a fact-specific analysis that need not be repeated here, the court held that the evidence did not support the finding of \$700,000 in actual damages.²²⁴ But the sufficiency discussion contains some language about damages that leads to a stare decisis problem.

In addressing sufficiency of the evidence, the Texas Supreme Court began by explaining the legal measure against which the proof was being tested.²²⁵ Had *Formosa* been a DTPA case, one would have expected the usual benign paraphrasing of *Leyendecker* to the effect that "misrepresentation" damages can be either out-of-pocket or benefit-of-the-bargain. But *Formosa* was a fraud case. Instead of following a century of law

²¹⁶ *Id.*

²¹⁷ *Id.* at 43–51.

²¹⁸ *Id.* at 44–45.

²¹⁹ *Id.*

²²⁰ *Id.* at 49.

²²¹ *See id.*

²²² *Id.* at 49–50.

²²³ *Id.* at 49–51.

²²⁴ *Id.*

²²⁵ *Id.* at 49.

that there is only one measure of damages for fraud, the court uprooted the *Leyendecker* paraphrase, rewrote it, and implanted it into the law of fraud.²²⁶ The court stated: “Texas recognizes two measures of direct damages for common-law fraud: the out-of-pocket measure and the benefit-of-the-bargain measure.”²²⁷ For the first time in history, and in contravention to the principle of following first-in-time decisions, the court stated that there are two measures of damages for fraud.²²⁸

What happened to *George*? Or *Morriss-Buick*? Or *Sobel*? For the better part of a century, the Texas Supreme Court held that benefit-of-the-bargain damages in fraud cases were illegitimate. Yet the *Formosa* dictum says the opposite. What are lower courts and litigants supposed to do now? Good lawyers should be using their skills to keep all the Texas Supreme Court’s precedents harmonious, with *Formosa* being authoritative on duty and *George*, *Morriss-Buick*, and *Sobel* being authoritative on the measure of damages. But perhaps the bar has forgotten the distinction.

Instead, the *Formosa* language began to snowball. In *Latham v. Castillo* the court cited *Formosa* for the proposition that benefit-of-the-bargain damages are available for “fraudulent misrepresentation.”²²⁹ It stated that a fraud plaintiff “may recover either the out-of-pocket or the benefit of the bargain damages, whichever is greater.”²³⁰ Just as in *Formosa*, the language is dictum because the court went on to hold that the evidence of damages was insufficient. But if any claim is repeated enough, readers may eventually treat it as law, which seems to have happened in the ensuing years.²³¹ Thus, the courts have come back to the precise fork in the road where they found themselves in 1906, but they do not seem aware of it.

²²⁶ *See id.*

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ 927 S.W.2d 66, 70 (Tex. 1998).

²³⁰ *Id.*

²³¹ The courts of appeals quickly got on the bandwagon of the *Formosa* language. *See, e.g.*, *Carr v. Christie*, 970 S.W.2d 620, 624 n.5 (Tex. App.—Austin 1998, pet. denied); *Hill v. Heritage Res., Inc.*, 964 S.W.2d 89, 111 (Tex. App.—El Paso 1997, pet. denied); *Green v. Allied Ints., Inc.*, 963 S.W.2d 205, 207–08 (Tex. App.—Austin 1998, pet. denied). The Supreme Court has since done likewise. *See Anderson v. Durant*, 550 S.W.3d 605, 614 (Tex. 2018) (“Two types of direct damages are available for common-law fraud: out-of-pocket damages, measured by the difference between the value expended versus the value received, and benefit-of-the-bargain damages, measured by the difference between the value as represented and the value received.”); *Zorrilla v. Aypco Constr. II, LLC*, 469 S.W.3d 143, 153 (Tex. 2015) (similar); *Aquaplex, Inc. v. Rancho La Valencia, Inc.*, 297 S.W.3d 768, 775 (Tex. 2009) (similar).

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FRAUD DAMAGES

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III. THE PROPER MEASURE OF DAMAGES FOR FRAUD AND ITS RATIONALE

A. *The out-of-pocket measure is correct as a matter of precedent.*

Under binding Texas Supreme Court precedent, the proper measure of damages for fraud is the out-of-pocket measure. The plaintiff should be able to recover the full amount of his reliance damages but should not be allowed to recover the benefit-of-the-bargain. This rule was foreshadowed in *Greenwood v. Pierce*, announced as the only holding in *George v. Hesse*, and reiterated in cases such as *Morriss-Buick v. Pondrom* and *Sobel v. Jenkins*.²³²

These decisions should remain good law today, at least according to the logic of *Mitschke*, which teaches that stare decisis in “an essential ingredient in the rule of law itself”²³³ and decries the notion that every day is “a new day in the life of the law.”²³⁴

None of the Texas Supreme Court’s DTPA decisions—from *Leyendecker* to *Arthur Andersen*—even confronted the issue of the measure of damages for fraud, let alone decided whether that measure should be expanded. Nor did *Formosa* say that it was overruling a century of precedent. There is no denying that *Formosa*’s language seems to run counter to *George*, but there is also no denying that that language was unnecessary to the decision. The issue in *Formosa* was sufficiency, not the measure of damages. Anyone who follows the Texas Supreme Court’s writings from *Leyendecker* to *Arthur Andersen* can see that the court simply paraphrased its own DTPA caselaw on a common-law issue that none of those cases had presented.

Of course, if the Texas Supreme Court wishes to overrule *George v. Hesse*, *Morriss-Buick v. Pondrom*, and *Sobel v. Jenkins*, it has the power to do so. But overruling a century of caselaw is a serious matter, and lawyers do a disservice to the court by assuming that a host of high court decisions was permanently buried without even a tombstone to mark the spot. It is more respectful to the court to assume that stare decisis counts for something and that decades of decisional law will not be jettisoned without a reasoned explanation. If *George*, *Morriss-Buick*, and *Sobel* have been overruled, someone should explain which Texas Supreme Court decision did the

²³² See 58 Tex. 130, 132–33 (1882); *George v. Hesse*, 93 S.W. 107, 107 (Tex. 1906); *Morriss-Buick Co. v. Pondrom*, 113 S.W.2d 889, 890 (Tex. [Comm’n Op.] 1938); *Sobel v. Jenkins*, 477 S.W.2d 863, 868 (Tex. 1972).

²³³ 645 S.W.3d 251, 256 (Tex. 2022).

²³⁴ *Id.* at 258.

overruling. If they have not been overruled, the out-of-pocket rule lives on, and the *Formosa* dictum should be disavowed for the non-binding background remark that it was.

B. The out-of-pocket measure is correct as a matter of theory.

In addition to the argument from precedent, there is a very powerful—no, a virtually unanswerable—analytical case to be made for the out-of-pocket measure. When one asks the question how much a plaintiff was defrauded out of, that question itself points to the out-of-pocket measure. As one treatise puts it, “[a]s a matter of the strict logic of the form of action, the first of these two rules [out-of-pocket] is more consistent with the purpose of tort remedies, which is to compensate the plaintiff for a loss sustained, rather than to give him the benefit of any contract bargain.”²³⁵

The discussion of contorts in the previous section of this article is helpful to determining the rationale for the proper measure of damages for fraud. Tort law typically seeks to return the injured party to the status quo ante, that is, to the position he occupied before the tort took place.²³⁶ Reliance damages carry out those purposes.

If a tort exists only because there is a duty imposed by law independent of the terms of the contract, then the terms of the contract should be irrelevant to the measure of damages for breach of that tort duty. Instead, the measure of damages should relate to the breach of the tort duty itself.

Perhaps the best way to approach the correct measure is to consider a simple hypothetical, which reflects a typical fraud case. A wants to buy a new Mercedes-Benz for \$50,000. B represents to A that this car is new. A pays B \$50,000. A learns later the car is really two-years old, with a market value of \$35,000. Leaving aside remedies under the DTPA, what can A recover at common law?

Suppose A sues for both breach of contract and fraud. His lawyer reasons that A was promised a new Mercedes-Benz, but he received a used one. That is a breach of contract. Alternatively, if the promise was simply to deliver a Mercedes-Benz, and its being new was merely a misrepresentation of its condition, then A can sue for fraud. Under *Formosa*, A can recover if the promise of a new car was made to induce him into the deal and was made with no intention of performing that promise.

²³⁵PROSSER & KEETON ON TORTS § 110, at 768 (5th ed. 1984) (footnote omitted).

²³⁶RESTATEMENT (THIRD) OF TORTS § 42 (AM. L. INST. 2012).

1. What damages are available?

The purpose of contract law is to fulfill expectations. Therefore, A is entitled to the benefit of his bargain, which is the difference in the value as represented and the value as received. A bargained for a brand-new car with a represented value of \$50,000, but he received a used car valued only at \$35,000. He is entitled to the difference in value between what he was promised and what he received: \$15,000 plus any consequential damages. A could also recover his attorneys' fees accrued in enforcing the contract.

The purpose of tort law, however, is to compensate for injuries suffered and to deter future wrongdoing. The duty breached is not contractual. It is a duty imposed by law not to fraudulently induce someone into a binding contract. So, A has two available remedies. The first is rescission: A could simply give back the car and ask for his money back. The second is the damages remedy: A could seek the damages he suffered from the misrepresentation. But A should not be able to recover the benefit of his bargain, since he is disavowing the bargain by suing for fraud in the inducement.

A's damages for fraud would be his out-of-pocket expenses in relying on the fraud. A would recover the difference between the value paid and the value received. A paid \$50,000, but received a car valued only at \$35,000. Thus, his actual damages would be \$15,000 plus consequential damages. But—most importantly for deterrence—A could also recover punitive damages.

A has the right to submit both claims to the jury and to elect the claim that provides him with the highest recovery. Therefore, in the example, A probably will choose the contract claim if the attorneys' fees exceed the punitive damages, or A probably will choose the fraud claim if the punitive damages exceed the attorneys' fees.

Thus, in many cases, the only cash difference between the measures of damages will not be in the actual damages awarded, but in the availability of either attorneys' fees or punitive damages. An exception occurs when the party was getting a particularly good deal under the contract. Let's explore that by changing the hypothetical. Suppose the same facts except the car, as new, really would be worth \$60,000 and was represented as such, though A was paying only \$50,000 for it. For breach of contract, A gets the difference between the value as represented and the value received, so A recovers \$25,000. But for fraud, A would get only the difference in the value paid and the value received, which is still \$15,000. Thus, when the party has been promised a great deal under the contract, the party can enforce that bargain

and recover more in actual damages than he can under a fraud claim. That is exactly as it should be. The damages for breach of the tort duty should not depend on the terms of the contract.

The whole notion of enforcing a fraudulent promise is at war with itself. By definition, a fraudulent promise is one that the maker never had any intention to perform. There is therefore no reason to expect any equivalence between the size of the maker's promise and the size of what he sought to get in return.

Consider the fraud-minded cab driver who agrees to give his gullible passenger the Brooklyn Bridge in exchange for the passenger's Rolex watch. There is no reason to equate the value of the Rolex watch with the value of the Brooklyn bridge. In fact, there is every reason to assume the opposite. The victim's damages are the value of the Rolex, not the value of the Brooklyn bridge. In the case of an untainted and bargained-for contract, the parties are presumed to have haggled themselves into a fair deal, so the law will enforce the promises as made. But in a fraud case, the bargaining process was fatally contaminated. The fraud-feasor might have promised his victim all the bullion in Fort Knox, but that does not make the nation's gold supply the measure of actual damages. One can certainly say that the wretched fraud-feasor deserves to be punished, but that is an argument for awarding punitive damages, not an argument for inflating the measure of actual damages.

2. Consequential damages

What if a fraud plaintiff alleges that the fraud caused him to lose a large amount of profits? If he testifies, "I would have made a mint," are his lost profits recoverable? The answer comes from the law of consequential damages.

Consequential damages, also known as special damages, are the secondary effects that flow from a wrongful act.²³⁷ They "result naturally, but not necessarily, from the defendant's wrongful acts."²³⁸ The Restatement divides tort damages into two categories: general damages and special damages.²³⁹ It defines general damages as "compensatory damages for a harm so frequently resulting from the tort that it is the basis of the action that

²³⁷ See *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 163 (Tex. 1992) (Phillips, C.J., concurring) ("consequential damages,' also known as 'special damages,' are those damages which result naturally, but not necessarily, from the acts complained of.").

²³⁸ *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816 (Tex. 1997).

²³⁹ RESTATEMENT (SECOND) OF TORTS § 904 (AM. L. INST. 1979).

the existence of the damages is normally to be anticipated and hence need not be alleged in order to be proved.”²⁴⁰ It defines special damages as “compensatory damages for a harm other than one for which general damages are given.”²⁴¹

Texas law honors this distinction between general and special damages, sometimes using the terms “direct” and “consequential” damages.²⁴² If a drunk driver runs over someone’s toe, the victim’s pain and suffering would qualify as general damages, whereas the victim’s loss of income from a night job as a rodeo clown would qualify as special or consequential damages.

The challenge to the law of consequential damages is to set up a boundary line beyond which the plaintiff’s losses become too remote to be recoverable.²⁴³ In contract cases, it is customary to look to the contemplation of the parties.²⁴⁴ But in tort cases, the contemplation of the parties is not a satisfactory test. For one thing, parties in tort cases frequently will not have dealt with each other, so they cannot have contemplated anything. Although the parties to a fraud case will have dealt with each other, there is something strange about focusing on the contemplation of the parties in a case where one of the parties is a fraud-feasor whose subjective thoughts ought not to be a useful measure for anything. If the defendant deliberately lied to the plaintiff during their dealings—as has to be true in a fraud case or else defendant would not be liable for damages at all—then it makes no sense to consult defendant’s subjective contemplation.

As a result, tort law has resorted to objective concepts such as reasonable certainty, foreseeability, and avoidable losses for its limiting principles.²⁴⁵ In

²⁴⁰ *Id.* § 904(1).

²⁴¹ *Id.* § 904(2).

²⁴² *Arthur Andersen & Co.*, 945 S.W.2d at 816; *Henry S. Miller Co.*, 836 S.W.2d at 163 (Phillips, C.J., concurring); *see also* *Wintz v. Morrison*, 17 Tex. 372, 385–86 (1856) (allowing consequential damages); TEX. R. CIV. P. 56 (requiring specific pleadings for consequential damages).

²⁴³ *See* RESTATEMENT (SECOND) OF TORTS § 912 (AM. L. INST. 1979) (certainty); *id.* § 918 (avoidable consequences).

²⁴⁴ *E.g.*, *Mead v. Johnson Grp, Inc.*, 615 S.W.2d 685, 687 (Tex. 1981); *see* *Stuart v. Bayless*, 964 S.W.2d 920, 921 (Tex. 1998) (consequential damages “are not recoverable unless the parties contemplated at the time they made the contract that such damages would be a probable result of the breach.”); *Hadley v. Baxendale*, 9 Exch. 341, 354 (1854).

²⁴⁵ *See* RESTATEMENT (SECOND) OF TORTS § 912 (AM. L. INST. 1979) (certainty); *id.* § 918 (avoidable consequences).

particular, the requirement of reasonable certainty is the primary limiting device for lost profit claims in cases of commercial wrongdoing.²⁴⁶

Any study of the measure of damages for fraud should take note of this distinction between direct and consequential damages because the out-of-pocket rule is a rule about direct damages. It says nothing about consequential damages. To return to the question posed earlier, may a fraud plaintiff recover the benefit-of-the-bargain as consequential damages?

In litigation, the question often arises as follows. P argues that he was going to make a profit on the deal with D. D counters by citing *George v. Hesse* for the out-of-pocket rule. D even quotes *Morriss-Buick* for the proposition that the purpose of fraud damages is to provide “compensation, not profit.” Who should win? The answer depends on what one means by profit.

If P merely wants the benefit of his bargain with D, then that is off-limits because of the out-of-pocket rule laid down by *George v. Hesse*. The “profit” on the two-party transaction is the same thing as the benefit-of-the-bargain, which *George v. Hesse* squarely rejects.²⁴⁷ On the other hand, if P would have made profits from a *third party*, then he is free to pursue those lost profits as consequential damages, subject to the routine limitation that he must prove his losses with reasonable certainty. For example, if P is a retailer who was going to buy from D and re-sell to the public, then there is no *per se* rule against P pursuing the profits he would have made on those sales to the public.

This view is consistent with precedent.²⁴⁸ It fits perfectly with Texas Supreme Court decisions in *Trenholm v. Ratcliff*²⁴⁹ and *Reid v. El Paso Construction Co.*²⁵⁰ In each case, a fraud plaintiff sought to recover lost

²⁴⁶ See, e.g., *Szczepanik v. First S. Tr. Co.*, 883 S.W.2d 648, 649 (Tex. 1994); *Tex. Instruments, Inc. v. Teletron Energy Mgmt., Inc.*, 877 S.W.2d 276, 279 (Tex. 1994); *Holt Atherton Indus., Inc. v. Heine*, 835 S.W.2d 80, 84 (Tex. 1992); *White v. Sw. Bell Tel. Co., Inc.*, 651 S.W.2d 260, 62 (Tex. 1983); *Pace Corp. v. Jackson*, S.W.2d 340, 348 (Tex. 1955); *Sw. Battery Corp. v. Owen*, 115 S.W.2d 1097, 1098 (Tex. 1938).

²⁴⁷ See 93 S.W. 107, 108 (Tex. 1906).

²⁴⁸ See, e.g., *Trenholm v. Ratcliff*, 646 S.W.2d 927 (Tex. 1983); *Reid v. El Paso Constr. Co.*, 498 S.W.2d 923 (Tex. 1973).

²⁴⁹ 646 S.W.2d at 927. One writer has suggested that *Trenholm* “affirmed” the benefit of the bargain measure for fraud. See Roach, *supra* note 126, at 19. A better reading of *Trenholm* may be that the lost profits award there came as consequential damages, not direct damages.

²⁵⁰ 498 S.W.2d at 925.

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profits as consequential damages.²⁵¹ In each case, the plaintiff's right to recover was tested against the traditional yardstick of reasonable certainty.²⁵²

This view is also analytically sound. It is entirely rational to rely on the forces of the market to set fair prices for a plaintiff's transactions with third parties. If the plaintiff can prove that the defendant's fraud caused him to lose a sale to XYZ Corp., then there is good reason to give prima facie weight to the amount of profit that the plaintiff was expecting from his contract with XYZ Corp., because a rational XYZ Corp. would presumably not have entered into a contract that was too lucrative for the plaintiff. By contrast, if the plaintiff was merely expecting a profit on the deal with the lying fraud-feasor, then there is no reason to expect the fraud-tainted deal to produce a fair price.

IV. THE FUTURE OF FRAUD DAMAGES

The common law of fraud has come back to the crossroads. It can head right, by following *George v. Hesse* and acknowledging the *Formosa* statements about fraud damages as simply unnecessary to the decision. Or it can head left, by expanding fraud damages to include the benefit of the bargain, on the theory that *George v. Hesse* stopped being the law at some point, even though nobody realized it at the time.

If the logic of *Mitschke* means anything, it means that the earlier decision ought to control. Although *Mitschke* dealt with the intermediate courts, its rationale should be at least as strong for a court of last resort, because high court opinions surely engender more reliance than the opinions of the intermediate courts. *George v. Hesse* was the first in time and should remain authoritative. But whatever decision the courts make, the choice ought to be made with full awareness of the prior precedent, because “[d]epartures from precedent must be carefully considered.”²⁵³

If the courts “carefully consider[]” whether to adhere to *George v. Hesse*, they should find its rule superior to the alternative. Professor Jill Wieber Lens has persuasively catalogued the reasons:

Benefit-of-the-bargain damages cannot be compensatory in tort, and none of the practical or theoretical justifications for awarding benefit-of-the-bargain-based compensatory

²⁵¹ *Trenholm*, 646 S.W.2d at 933; *Reid*, 498 S.W.2d at 925.

²⁵² *Trenholm*, 646 S.W.2d at 933; *Reid*, 498 S.W.2d at 925.

²⁵³ *Mitschke v. Borromeo*, 645 S.W.3d 251, 263 (Tex. 2022).

damages for breach of contract apply to tort law. To restore the meaning of compensatory damages in tort law, courts must limit compensatory damages for fraudulent misrepresentation to the plaintiff's out-of-pocket losses. The purpose of benefit-of-the-bargain damages is, and always has been, to punish the defendant because he committed fraud; these are punitive damages in tort.²⁵⁴

It is thus “time to stop pretending that benefit-of-the-bargain damages are compensatory damages in tort. Clearly, the damages put the plaintiff in a better position than before the tort by providing a financial windfall. Moreover, if the damages were truly compensatory, they would also be available for negligent misrepresentation.”²⁵⁵ That last point deserves emphasis because Texas has committed itself to the notion that the measure of damages for negligent misrepresentation is the out-of-pocket measure, not the benefit-of-the-bargain measure.²⁵⁶

To reject *George v. Hesse* and allow expectancy damages would create the strange situation where P can prevail with the following position: “*D tricked me into a contract so desirable that I don’t want it rescinded. I want it enforced. I might even like exemplary damages for that breach of promise.*”

Although the preceding arguments seem unanswerable, it is risky to put too much faith in the power of ideas. After all, other jurisdictions have split over the right measure.²⁵⁷ But resolving a “conflict of authority upon the point”²⁵⁸ is precisely why the Texas Supreme Court accepted the certified question in *George* in the first place. If *Mitschke* means anything in pledging allegiance to precedent as the foundational rule of stare decisis, a return to *George* would make a good starting point. Plus, reaffirming the out-of-pocket rule would restore some rationality to the law in an area that needs it. If the rule of *George* is to end, let it end only after a full debate about the pros and cons of the issue that the Texas Supreme Court thought it was resolving once

²⁵⁴Jill Wieber Lens, *Honest Confusion: The Purpose of Compensatory Damages in Tort and Fraudulent Misrepresentation*, 59 U. KAN. L. REV. 231, 232 (2011).

²⁵⁵*Id.* at 283.

²⁵⁶*D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 663–64 (Tex. 1998); *Fed. Land Bank Ass’n of Tyler v. Sloane*, 825 S.W.2d 439, 443 (Tex. 1991).

²⁵⁷See, e.g., Edward J. Normand, *Damages for Deceit: A Case Study in the Making of American Common Law*, 71 N.Y.U. ANN. SURV. AM. L. 333, 337 (2016) (“The damages element of fraud, however, stands out as an area in which the state courts not only have taken different approaches, but also have struggled to rule consistently.”).

²⁵⁸*George v. Hesse*, 93 S.W. 107, 107 (Tex. 1906).

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and for all in 1906. The law of damages has plenty of hard questions, but this does not look like one of them.