IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

United States Court of Appeals
Fifth Circuit
FILED
December 19, 2019
Lyle W. Cayce
Clerk

No. 18-11387

CORRECT RX PHARMACY SERVICES, INCORPORATED,

Plaintiff - Appellee

v.

CORNERSTONE AUTOMATION SYSTEMS, L.L.C.,

Defendant - Appellant

Appeals from the United States District Court
for the Northern District of Texas

Before HIGGINBOTHAM, DENNIS, and HO, Circuit Judges.

JAMES L. DENNIS, Circuit Judge:

Defendant Cornerstone Automation Systems, L.L.C. ("CASI") contracted with Plaintiff Correct Rx Pharmacy Services, Inc. ("Correct Rx") to supply a custom automated pharmacy system by a specified deadline. CASI failed to deliver, and Correct Rx brought the present diversity action. Rather than bringing a breach of contract claim, Correct RX asserted a Texas common law tort claim for negligent misrepresentation based on various alleged misstatements CASI had made over the course of their dealings regarding its experience, resources, and capabilities. The jury found in favor of Correct Rx, and CASI appeals the district court's denial of its subsequent motion for judgment as a matter of law. CASI argues that Texas's "economic loss rule"

precludes tort liability for economic losses resulting from a defendant's negligence in negotiating or fulfilling a contract between the parties.

On review, we hold that the district court correctly determined that Texas's economic loss rule does not preclude Correct Rx's tort claim, and, accordingly, we AFFIRM.

I.

A.

Correct Rx is a Maryland-based licensed institutional pharmacy that primarily services correctional facilities and other government entities. In 2013, Correct Rx's Manager of Operations, Dr. Jaye Wexler, viewed an internet video of CASI's customizable warehouse automation system, SolidSuite. Hoping to increase the efficiency of Correct Rx's operations, Wexler contacted CASI's Texas headquarters to inquire whether the company knew of any businesses offering similar automated solutions for packaging and shipping medication. CASI's Director of Pharmacy Sales, Mark Gillet, introduced Wexler to CASI founder Michael Doke, and the two informed Wexler that CASI was itself working in the pharmacy industry. Gillet and Doke asserted that CASI had already created SolidSuiteRx, an adaptation of its standard software that was optimized for pharmacy use.

They stated that CASI had previously supplied an automated system much like the one Correct Rx was interested in to the California Department of Correction and Rehabilitation ("CDCR"), and Gillet related his belief that "a very similar system" would be "the ultimate solution" for Correct Rx's needs. Correct Rx alleges that CASI repeatedly and falsely assured Correct Rx at this meeting and over the following ten months that creating its pharmacy automation system would require only minor adaptations from products that

the company had already fully developed for its other institutional pharmacy clients.[1]

As the companies negotiated and drew closer to a purchase agreement, Correct Rx informed CASI in April 2014 that its lease on its current workspace was expiring and that it was preparing to lease a larger facility to accommodate the new automation system. It was thus a priority that the system be installed by November 2014 in order for it to be fully functional when Correct Rx began operations at the new facility on January 1, 2015. This would allow for a 30-week timeline for CASI to completely develop and install the system.

Doke, who was in charge of CASI's engineering and software development, met with two CASI project managers, Carlos Jiminez and Kory Ballew, to discuss whether CASI would be able to meet the deadline. Both Jiminez and Ballew, the latter of whom would become the manager of the Correct Rx project, informed Doke that they did not believe it was possible to complete and install the system within 30 weeks. At that time, CASI had never completed and installed a pharmacy-automation system in less than 104 weeks. Jiminez would later testify that no pharmacy-automation project he had worked on had been delivered on-time. The CDCR account had taken three years and ten deadline extensions to complete, and a system CASI had

[1] CASI generally disagrees with this account of its statements and contends that it was consistently truthful regarding the current state of the technology it offered. Specifically, CASI asserts that Gillet initially discussed with Wexler installing a system like the one it had provided to CDCR, which was a fully developed product that would have required only incorporating Correct Rx's unique "business rules." However, CASI claims that Correct Rx subsequently requested that the system include "robotic on-demand packaging" after seeing in a PowerPoint presentation that CASI was developing the technology for another client. Correct Rx was aware that the technology had not yet been installed at any customer's site, CASI contends. Correct Rx disputes that it was the party to initially propose incorporating robotics. According to Correct Rx, Gillet introduced the concept and suggested additional system modifications to accommodate the technology after Correct Rx initially expressed disinterest due to its inadequate rate of production. Correct Rx denies that CASI disclosed it had not yet completed or installed any pharmacy-automation systems that utilized robotics.

contracted to supply to the United States Veterans Administration was incomplete as of the date of trial despite eight deadline extensions. CASI did not disclose these facts to Correct Rx.

Despite the reservations expressed by the project managers, CASI informed Correct Rx that it would agree to the 30-week timeline for installation. To facilitate this accelerated timeline, CASI requested an "enhanced" down payment of 52.5% of the contract price so that it could immediately order components with "long lead times"—those parts that would take a protracted period to manufacture, deliver, or assemble. Correct Rx agreed to the enhanced down payment, and the parties signed a contract on May 1, 2014, with an agreed upon purchase price of $4,194,654.

For unspecified reasons, CASI experienced delays in starting the initial assembly of the system. In late July 2014, CASI informed Correct Rx that it would not meet the 30-week deadline. Correct Rx proceeded to secure an extension of its previous lease so as to still allow CASI to install the automated system in an empty workspace at its new location. On September 10, 2014, the parties entered into an amended agreement extending the delivery deadline to March 6, 2015, in exchange for a $200,000 reduction in the purchase price.

Correct Rx contends that CASI made additional false representations during this period in order to conceal its lack of progress on the system. Correct Rx also claims that CASI misrepresented its use of the enhanced down payment it required of Correct Rx, pointing to a progress chart Dr. Wexler viewed during site visits in August 2014 and January 2015 that indicated procurement of long-lead items was still zero percent complete.

From 2014 to early 2015, CASI continued to experience mechanical problems that caused additional delays. As a result, CASI did not meet the March 6, 2015 amended deadline to complete the Correct Rx system. Then,

during a July 1, 2015 meeting, Doke made statements that Correct Rx's management interpreted to mean that the SolidSuiteRx software that had been presented to them as a finished product was only 80% complete.[2] Because Correct Rx believed that it had been misled, the company demanded that CASI return the portion of the purchase price it had paid.

B.

On September 15, 2015, Correct RX filed suit in the United State District Court for the Northern District of Texas. Correct Rx asserted Texas common law tort claims for fraud and negligent misrepresentation, alleging that CASI had made false statements to induce it to enter into the contract and to agree to the March 6, 2015 deadline extension.[3] The case proceeded to jury trial in 2018. Following the close of evidence, the jury returned a special verdict finding CASI liable for only negligent misrepresentation. It awarded Correct Rx the deposits it had paid to CASI, the extra rent and office expenses resulting from the extension of its previous lease, the interest paid on its equipment loan, and $73,390 in unspecified out-of-pocket expenses for a total of $3,131,064.99 in damages.

Before the district court entered judgment on the jury's verdict, CASI renewed the properly preserved motion for judgment as a matter of law that is

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[2] CASI contends that, prior to the meeting, Doke discovered that CASI's software programmers had "tweaked" aspects of the base system that the company had previously provided to CDCR, and that Doke's comment was in reference to his progress restoring the software to its original design.

[3] CASI responded by filing a motion to dismiss and compel arbitration, arguing that Correct Rx was essentially bringing a breach of contract claim based on CASI's nonfeasance and that a mandatory arbitration provision in the agreement precluded Correct Rx from pursuing its claim in district court. The district court denied the motion. Because "[c]laims of fraudulent inducement arise from a general obligation imposed by law, not the underlying contract," the court ruled that Correct Rx's claims did not fall within the scope of the arbitration agreement. (Quoting *In re Kaplan Higher Education Corp.*, 235 S.W.3d 206, 209 (Tex. 2007).)

the subject of this appeal. Under Texas law, CASI argued, "[t]he economic-loss rule . . . generally precludes recovery in tort for economic losses resulting from the failure of a party to perform under a contract." (Quoting *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 12 (Tex. 2007).) CASI contended that all of Correct Rx's damages could have been recovered under a breach of contract claim, and the company had thus failed to establish the "distinct, separate, and independent" injury necessary to support tort liability. (Quoting *Sterling Chems., Inc. v. Texaco, Inc.*, 259 S.W.3d 796, 796 (Tex. App. 2007).)

The district court issued a memorandum opinion and order denying CASI's motion. Reviewing Texas caselaw on the economic loss rule, the court observed that whether the doctrine bars a tort claim tends to turn on three interrelated issues: (1) the source of the duty that was breached; (2) whether the breach occurred in the inducement or in the course of performance; and (3) whether the damages sought are benefit-of-the-bargain expectancy damages or out-of-pocket reliance damages. The court found that the doctrine categorically "does not bar a claim for out of pocket or reliance damages caused by a negligent misrepresentation that induced a party to enter into a contract." Because Correct Rx recovered only out-of-pocket damages and not benefit-of-the-bargain expectation damages, the court determined that the jury's award was proper. The present appeal followed.

II.

A motion for judgment as a matter of law in this context is a challenge to the legal sufficiency of the evidence supporting the jury's verdict. *Ford v. Cimarron Ins. Co.*, 230 F.3d 828, 830 (5th Cir. 2000). This court reviews the district court's ruling *de novo*, applying the same legal standard as the trial court. *Brown v. Bryan County*, 219 F.3d 450, 456 (5th Cir. 2000). Thus, "judgment as a matter of law is proper after a party has been fully heard by the jury on a given issue, and there is no legally sufficient evidentiary basis for

a reasonable jury to have found for that party with respect to that issue." *Ford*, 230 F.3d at 830 (internal quotation marks and citation omitted).

III.

A.

As the district court observed, "[T]here is not one economic loss rule broadly applicable throughout the field of torts, but rather several more limited rules that govern recovery of economic losses in selected areas of the law." *Sharyland Water Supply Corp. v. City of Alton*, 354 S.W.3d 407, 415 (Tex. 2011) (quoting Vincent R. Johnson, *The Boundary–Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 534–35 (2009)). Under Texas law,[4] one such rule applies when a contractual relationship (or at least some approximation thereof) exists between the parties to a suit. *See* William Powers, Jr. & Margaret Niver, *Negligence, Breach of Contract, and the "Economic Loss" Rule*, 23 TEX. TECH L. REV. 477, 488 (1992). This contractual economic loss rule precludes a party from bringing a tort action based only on a defendant's breach of duties imposed by a contract, instead limiting plaintiffs to a common law breach of contract suit or its statutory equivalent. *Id.* For example, in *Jim Walter Homes, Inc. v. Reed*, the Texas Supreme Court reversed an award of exemplary damages that a couple recovered in a suit against a contractor for gross negligence in the construction of their home. 711 S.W.2d 617, 617–18 (Tex. 1986). The court reasoned that the couple's claim—"that the house they were promised and paid for was not the house they received"—was

[4] Because this case was brought pursuant to the district court's diversity jurisdiction, this court applies state law as it would be applied by the state's highest court. *See, e.g.*, *Lamb v. Ashford Place 26 Apartments*, 914 F.3d 940, 944 (5th Cir. 2019) (citation omitted). The parties do not dispute that Texas law governs whether Correct Rx's claim is barred by the economic loss rule. As there is no directly on-point Texas Supreme Court decision, we make an "*Erie*-guess" as to how that court would rule. *See Shakeri v. ADT Sec. Servs., Inc.*, 816 F.3d 283, 290 (5th Cir. 2016) (citing *Erie R.R. Co. v. Tompkins,* 304 U.S. 64 (1938)).

essentially a claim for a breach of the construction contract, and "[g]ross negligence in the breach of contract will not entitle an injured party to exemplary damages because even an intentional breach will not." *Id.* (citing *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 571 (Tex. 1981)). Similarly, in *Southwestern Bell Telephone Co. v. DeLanney*, the court held that a phone company's negligent failure to publish a paid-for advertisement in its yellow pages was simply a breach of the contract, and the advertiser thus could not bring a tort claim for lost profits. 809 S.W.2d 493, 495 (Tex. 1991).

But the contractual economic loss rule does not bar all tort claims between contracting parties. Under Texas law, the rule does not apply to claims that are sufficiently independent from the underlying contract. The precise test for determining when a tort claim is far enough removed from a contract to avoid the rule's preclusive effect has evolved throughout the development of the doctrine. Initially, Texas courts looked solely to the legal duty that the defendant breached, permitting recovery if the duty arose from a source of law independent of the contract. *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 45 (Tex. 1998) (citing *Int'l Printing Pressmen & Assistants' Union v. Smith*, 198 S.W.2d 729, 735 (Tex. 1946)). The Texas Supreme Court summarized this test in an early case by stating, "[A]n action in contract is for the breach of a duty arising out of a contract either express or implied, while an action in tort is for a breach of duty imposed by law." *Int'l Printing*, 198 S.W.2d at 735 (quoting 1 C.J.S., ACTIONS § 44).

Under this formulation, the contractual economic loss rule bars a tort claim when there would be no basis for relief if the parties had not entered into a contract and both parties' performance had instead been rendered gratuitously. *See id.* ("It is sometimes said that 'if the action is not maintainable without pleading and proving the contract . . ., it is, in substance,

an action on the contract, whatever may be the form of the pleading.'" (quoting 1 AM. JUR. 442)); *see also* Powers & Niver, *supra*, at 500-01. In *Montgomery Ward & Co. v. Scharrenbeck*, for instance, homeowners brought a negligence action against a store that improperly repaired their kerosene hot water heater after the heater malfunctioned and burned down their home. 204 S.W.2d 508, 510 (Tex. 1947). The Texas Supreme Court held that, although the defendant breached its contract by failing to repair the hot water heater properly, the defendant also breached a common-law duty of care by burning down the plaintiffs' home, and the tort was therefore an independent ground for recovery. *Id.* Because the store had affirmatively undertaken the repair of the hot water heater, it assumed a duty to do so with reasonable care under standard tort principles, and a negligence claim would lie for its breach of that duty even if no contract had existed. Powers & Niver, *supra*, at 500-01.

Later, the Texas Supreme Court "overlaid" this inquiry about the source of the breached legal duty with an analysis of the "nature of the injury" asserted and of the remedy sought by the plaintiff. *Formosa Plastics*, 960 S.W.2d at 45. This has generally become known as the "independent injury requirement," and subsequent cases have confirmed that it is a distinct test separate from determining whether the defendant breached an independent legal duty. *See D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 663 (Tex. 1998) (per curiam) ("Without deciding whether HISD breached a legal duty independent of its contractual duties, we conclude that HISD's negligent misrepresentation claim must fail for lack of any independent injury." (emphasis omitted)).

The Texas Supreme Court has expressly equated the independent injury requirement with the type of damages the plaintiff seeks. In *D.S.A., Inc. v. Hillsboro Independent School District*, for example, a school district sued a construction company for negligent representations it made in connection with

the defective construction of an elementary school. 973 S.W.2d at 663. A jury found for the school district and awarded the cost of repairing the defective structure. *Id.* The Texas Supreme Court reversed, holding that the school district was essentially seeking benefit-of-the-bargain damages, which are not available in a negligent misrepresentation suit. *Id.* (citing RESTATEMENT (SECOND) OF TORTS § 552B (limiting recovery for a negligent misrepresentation claim to reliance damages)). The court held that, because the school had sought expectation damages, it had failed to satisfy "the independent injury requirement of section 552B of the RESTATEMENT (SECOND) OF TORTS." *Id.* Thus, the independent injury requirement is satisfied under Texas law when a plaintiff endeavors to recover only out-of-pocket expenses in a negligent misrepresentation suit.

B.

Turning first to whether Correct Rx established a breach of an independent legal duty, the jury appears to have determined that CASI misrepresented its resources and capabilities during pre-contract negotiations or during negotiations for the contract modification to extend the deadline.[5] Under the negligent misrepresentation framework set forth in section 552 of

[5] CASI does not raise any argument that the jury could have instead found liability based on only CASI's pledge to fulfill the contract—that is, CASI's representation that it *would* fulfill the contract rather than CASI's representations that it *could* fulfill the contract—and that this specific alternative ground would be barred by the economic loss rule. Were it to do so, it would essentially be arguing that the district court's jury charge was not a fully accurate statement of the law because it did not preclude the jury from finding liability on an invalid basis. Although CASI objected to the jury instruction on negligent misrepresentation before the district court, it has not raised this issue on appeal and instead challenges only the district court's denial of its motion for judgment as a matter of law. Judgment as a matter of law is proper only when "there is *no* legally sufficient evidentiary basis for a reasonable jury to have found for that party with respect to that issue." *Foreman v. Babcock & Wilcox Co.*, 117 F.3d 800, 804 (5th Cir. 1997) (emphasis added) (quoting FED. R. CIV. P. 50(a)). Because we hold that at least one permissible basis exists on which the jury could have found liability, we need not consider this alternative possibility.

the SECOND RESTATEMENT, which the Texas Supreme Court adopted in *Federal Land Bank Ass'n of Tyler v. Sloane*, a party has a legal duty to use reasonable care when supplying information in the course of its business for the guidance of others in their business, and this duty exists independent of any contractual obligation. 825 S.W.2d 439, 442 (Tex. 1991). Applying this principle here, CASI had a duty to use reasonable care in obtaining and communicating information about its operations to Correct Rx for the purpose of guiding Correct Rx's decision on whether to purchase CASI's automated-pharmacy system. *See id.* (holding that a business "has a duty to use reasonable care whenever it provides information to its customers or potential customers").

There is ample evidence in the record from which a reasonable juror could have concluded that CASI breached this obligation, which is a "duty imposed by law" and not one "arising out of a contract either express or implied." *Int'l Printing*, 198 S.W.2d at 735. Had the parties abandoned the automation system project prior to entering into the contract, CASI would still be liable to Correct Rx for any travel or other out-of-pocket expenses Correct Rx incurred in reasonable reliance on the false information CASI negligently provided.[6] This is to say that it is not necessary for Correct Rx to prove that a contract existed between it and CASI to recover based on the misrepresentations that CASI negligently made. *Cf. id.* ("It is sometimes said that 'if the action is not maintainable without pleading and proving the contract, . . . it is, in substance, an action on the contract, whatever may be the form of the pleading.'"). Correct Rx has therefore successfully established that

[6] That this represents a breach of an independent duty is demonstrated by the fact that pre-contract reliance damages are generally unrecoverable in a breach of contract suit. *See Hollywood Fantasy Corp. v. Gabor*, 151 F.3d 203, 214 n. (5th Cir. 1998).

CASI breached a legal duty independent of those imposed by the parties' contract, as it is required to do to avoid tort claim preclusion under Texas's contractual economic loss rule.[7]

What remains is the simple determination of whether Correct Rx satisfied Texas's independent injury requirement by recovering only the damages permitted in a negligent misrepresentation suit under section 552B of the SECOND RESTATEMENT. *See D.S.A., Inc.*, 973 S.W.2d at 663. This provision permits recovery "for the pecuniary loss" resulting from "the plaintiff's reliance upon the misrepresentation." RESTATEMENT (SECOND) OF TORTS § 552B(1)(a)-(b). It prohibits recovery of "the benefit of the plaintiff's contract with the defendant." *Id.* at (2). As the district court determined, Correct Rx recovered only its out-of-pocket expenses, placing it back into the position it occupied before its detrimental reliance on CASI's negligent misrepresentations. The company did not recover the value of what CASI had promised. Given this straightforward analysis, the district court also did not err in finding that Correct Rx had satisfied Texas's independent-injury requirement. Having established a breach of an independent duty and an

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[7] CASI argues that this court should follow the draft THIRD RESTATEMENT OF TORTS, which has adopted the bright line rule that "there is no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between the parties." RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 3 TD No 1 (2012); *see also id.* at cmt. d ("Some courts have used RESTATEMENT SECOND, TORTS § 552—the predecessor to § 5 of this Chapter—to hold sellers liable for negligent misrepresentations that cause buyers to enter into contracts with them. The rule of this Section eliminates the tort claim in that circumstance."). CASI contends that the Texas Supreme Court approvingly cited this provision in *LAN/STV v. Martin K. Eby Const. Co.*, 435 S.W.3d 234, 243 (Tex. 2014). But the Texas Supreme Court merely observed in *LAN/STV* that "[t]he RESTATEMENT now concludes generally that 'there is no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between the parties.'" 435 S.W.3d at 243. It did not endorse this view, and, indeed, explicitly departed from the THIRD RESTATEMENT's approach to negligent representation and the economic loss rule in other respects. *See id.* at 247 ("[W]e diverge from the RESTATEMENT."). In the absence of a more explicit endorsement, we consider the Texas Supreme Court's previous caselaw controlling.

independent injury within the meaning of Texas law on the matter, Correct Rx's recovery was not precluded by the Texas contractual economic loss rule.

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In accordance with the foregoing, we AFFIRM the district court's denial of CASI's motion for judgment as a matter of law.