



Legal Beat

By MICHAEL SEAN QUINN

Negligent Misrepresentation—Part II

Editor's note: The first portion of this article appeared in our April 10 issue, page 28.

The tort of negligent misrepresentation protects commerce from loss-produc-

ing, negligently supplied misinformation. It is restricted to the world of business transactions, broadly understood. Actual damages do not include mental anguish. Punitive damages are not recoverable in Texas, even

in grossly negligent misrepresentation cases. Attorneys' fees incurred in the negligent misrepresentation lawsuit are not recoverable, although such fees expended previously in reliance upon negligently provided false information are recoverable.

Measuring damages

There has been controversy over how to measure damages in negligent misrepresentation cases. In *D.S.A., Inc. v. Hillsboro Independent School District* (1998), the Texas Supreme Court said that the measure of actual damages is not what lawyers call benefit-of-the-bargain damages but out-of-pocket (reliance) damages.

Out-of-pocket damages are the difference between the value of what the buyer paid and the value of what he received. Benefit-of-the-bargain damages are the difference between the represented value of the thing or service purchased and the value actually received. Out-of-pocket damages are usually measured at the time of sale.

In *D.S.A. v. Hillsboro*, a school district hired a contractor to build an elementary school. The building suffered from severe defects. The roof leaked badly and poor drainage buckled sewer lines under the building. Repair costs slightly exceeded \$220,000.

The court described the tort of negligent misrepresentation succinctly. Rather, "[n]egligent misrepresentation implicates only the duty of care in supplying commercial information; honesty or good faith is no defense, as it is to a claim of fraudulent misrepresentation." It does not have to do with honesty. At the same time, a mere breach of contract does not constitute negligent misrepresentation.

Breaches of contract do not require negligence. This is true even if there is a variance between defendant-provided specifications—which looks like a type of representation—and defendant-performed work. But specifications say how something should be done, not what it's already like. Hence, the failure of work to conform to specs is nothing but a breach of contract.

In order for there to be the tort of negligent misrepresentation, in a situation where there is also a breach of contract, there must be an independent injury. There must be damages that a breach of contract action will not cover. Since the usual measure of contract damages is benefit-of-the-bargain, there must be out-of-pocket damages not covered in the contract action, but covered in the tort action. Such damages are not easy to find.

In *D.S.A. v. Hillsboro*, the Texas Supreme Court unanimously held that money spent to bring the building into conformity with the original specifications constituted benefit-



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of-the-bargain damages, and not out-of-pocket damages.

Closer to home

An insurance agent suffered as a result of the D.S.A. rule not long ago. In *Metropolitan Life v. Haney* (1999), a life insurance agent presented an inaccurate illustration based upon computer software provided by the insurance company. Key-man life insurance was involved. The program omitted impor-



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tant information. The insured sued both the agent and MetLife. The jury found that the agent and insurer were each 50 percent negligent, but it awarded the agent \$50,000 on his cross-claim against the insurer for lost earning capacity and another \$50,000 for actual monetary losses.

In the Houston Court of Appeals, the agent lost. He did not show sufficient physical impairment to sustain an award for loss of earning capacity. He did not show monetary loss. Since Haney alleged negligent misrepresentation against the insurance company, monetary losses were restricted to out-of-pocket losses. He was unable to show any such losses.

Perhaps this result illustrates the deficiencies in the out-of-pocket rule for measuring damages under the tort negligent misrepresentation. It certainly indicates that the courts are insufficiently sensitive to the relationship between stress and debilitation when dealing with professionals and those involved in complex sales. Perhaps the result obliquely says that negligent misrepresentation, the tort, cannot be used where the parties have a contract.

Business, non-business distinctions

As indicated, the tort of negligent mis-

representation is restricted to business contexts. In 1997, the Tennessee Supreme Court unforgettably distinguished between business and non-business contexts in *Robinson v. Omer*.

In this case, a contractor (C) built a building, reserving part of it for his use. It was constructed in such a way that it had a secret room that could be viewed from a still more secret room. Video cameras were concealed in the more secret room.

C asked his friend, Robinson (R), to videotape his sexual escapades. The stated reason was that C didn't want to be accused of rape. R expressed doubt, but C said that he had asked his lawyer, Omer (O), about doing this and that O had opined that there was nothing wrong with it. Based upon that representation, according to R, he secretly videotaped sexual encounters from 1986 to 1993. Seven years!

Eventually, the dog food fell in the

fan, and R paid damages for the torts of invasion of privacy and outrageous conduct. (The second of these torts is unknown in Texas but it may be similar to intentional

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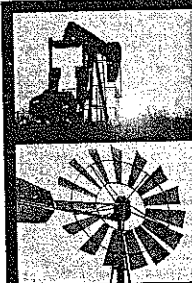
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infliction of emotional distress.)

R filed suit against O for negligent misrepresentation. O was not R's lawyer. The Tennessee Supreme Court held that non-clients of lawyers could sue those lawyers for negligent misrepresentation. The court observed, however, that negligent misrepresentation was actionable only in business contexts. The advice O had given C for R was not provided for guidance in a business transaction. The tapings were in no way business-related. The lawsuit, therefore, failed, as a matter of law. The story of O has absolutely general application. Consequently, let

voyeuristic folk—of whatever gender—with video talents beware.

How this affects agents

Courts are skeptical of the tort of negligent misrepresentation. Still, insureds regularly use the tort of negligent misrepresentation against insurance agents. Suppose that an insurance agent sells a customer, a tenant in a shopping center, an insurance policy that does not meet the requirements of the tenant's lease, say, to add the landlord as an additional insured. But the insurance agent represents to the landlord that he either will be or is an

additional insured. This might well be one of the patterns where negligent misrepresentation cases could be brought against insurance intermediaries. Hypotheticals like this can be generated forever.

Real cases involving negligent misrepresentation have arisen recently against insurance agents and brokers. In virtually every jurisdiction, an insurance agent can—under at least some circumstances—be liable for failing to explain policy terms correctly.

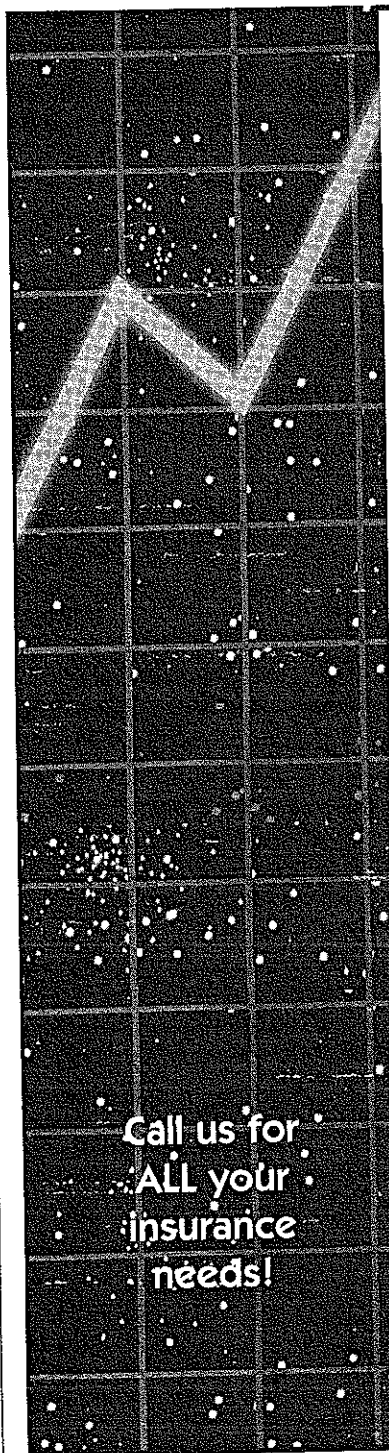
In some jurisdictions, such liability can accrue, even when a policy document is physically issued, the policy is clear and the insured could have read it. In other jurisdictions, the agent is liable only if the insurer fails to actually issue the policy. Since it is not uncommon for insurance companies to fail to issue policies, agents have some exposure in this regard.

It is very common for insureds to claim that their insurance agents have misexplained (and, therefore, misrepresented) policy terms to them, when they have not. ("I asked for full coverage, and my agent said, 'No problem! You've got it.'") Although there are no explicit, black-and-white rules on this matter, it is obvious that courts understand that many insureds are tempted to make up stories incriminating insurance agents. Consequently, courts are leery of these cases.

"But-my-agent-said" cases are usually not very strong ones. In Texas, negligent mis-explanation before the policy is purchased is probably defeated if the contract is clear. This is true for both contract reasons and tort reasons. Parties to contracts should read them and think about them. There is overwhelming comparative negligence on the part of the insured if he receives a policy, after having received a false explanation from the agent, and does not read it.

Agents may have some liability for negligent misrepresentation made after a policy has been issued. I was once on vacation and called my agent to determine whether a boat my family wanted to use was covered or not. He responded that it was. I later determined that he was wrong. I was in the wilderness, and I didn't have my policy with me. I couldn't read it for myself. Chances are that my agent would have been liable for negligent misrepresentation if I had rammed anything with the boat. But for how much?

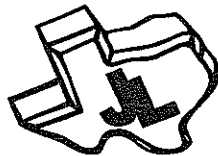
Similarly, if an insured refrains from buying additional insurance because his policy is extremely complicated, or wasn't ever issued, and his agent fails to explain something to him, the agent may have liability. But again, for how much? Is the insured's action a tort or for contract?



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Negligent misrepresentation must be distinguished from negligent-advising. Negligent misrepresentation almost always has to do with statements about facts. In many jurisdictions, a failure to speak on a topic—a silence—cannot constitute negligent misrepresentation. Negligent advising is much more like malpractice. In many jurisdictions, insurance agents have no duty to advise, because there is no special relationship between the insured and the agent.

This is probably the rule in Texas. However, if an agent has undertaken to provide some advice, the advice had better be appropriately thorough and correctly conceived. Don't agents almost always provide some advice?

In general, agents do not have a duty to know whether insurance companies are solvent. However, if an agent has some indication that an insurer is in financial trouble, he has a duty to warn customers about that fact. So, in reality, agents have some conditional duty to advise.

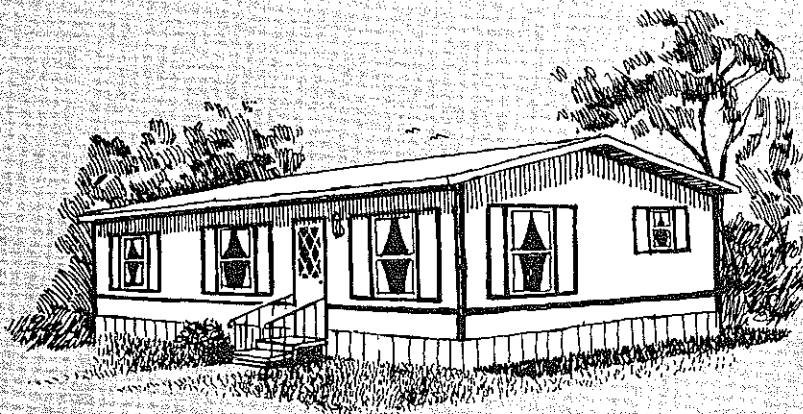
Insurance agents, since they perform an intermediation function, have exposure both to insureds and to insurers. For example, the Massachusetts Supreme Court indicated in 1998, that if an insurance agent negligently assists an insured in providing false information to an insurer, the agent may be liable.

Apparently, the insurance broker has liability irrespective of the insured's state of mind. The insured may have provided information negligently, or he may have provided it fraudulently. From the point of view of the broker's liability, it does not matter, if the broker was negligent.

A great danger

Negligent misrepresentation is the second greatest litigation danger honest insurance agents face, after breach of contract. Almost any statement an insurance agent makes about insurance to a customer, and any statement she makes to an insurance company, is going to be part of her business. It is therefore governed by the law of negligent misrepresentation. Any error can create liability. Fortunately for the agent, and for their E&O carriers, such liability is limited. Still, anything less than "i"-dotting and "t"-crossing practices is dangerous. ■

Quinn is an Austin shareholder in the law firm of Sheinfeld, Maley & Kay. He is mostly involved in litigation problems involving insurance coverage. Many of the problems upon which he works involve conduct of lawyers. He testifies from time to time on insurance related issues and on issues pertaining to the conduct of lawyers.



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