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CONSTRUCTION AND SURETY LAW

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I. INTRODUCTION

DURING late 2006 and throughout 2007, the Texas Supreme Court remained active in issuing opinions affecting the construction area. Most notably, the supreme court continued to apply its refined waiver by filing suit concept in the area of suits against cities and issued a long-awaited decision on the issue of Commercial General Liability ("CGL") coverage for alleged construction defects. The construction and surety cases decided by the courts of appeals covered a wide variety of topics, including waiver of governmental immunity, arbitration, mechanic's liens, payment and performance bond claims, general construction disputes, and the statute of limitations.

II. SOVEREIGN IMMUNITY

Consistent with the last several Survey periods, the issues of governmental immunity, waiver of immunity from suit, and suits against public entities permitted under new state legislation in the context of construction disputes have remained hot topics in Texas courts. Many decisions

featured in the last few articles of the Survey were resolved by the Texas Supreme Court in June 2006, when the supreme court issued its final decisions and rulings on two very important waiver of immunity concepts.

During late 2006 and throughout 2007, both the Texas Supreme Court and numerous courts of appeals applied the 2006 decisions in both pending cases for which rehearing was sought and in new cases. Many courts continued to interpret the scope of waiver included in the Government Code statute for suits against a public entity.

As has been covered in the last several Survey articles, the Texas Supreme Court has significantly refined the law on immunity from suit since the beginning of this decade. The 2001 opinion in *General Services Commission v. Little-Tex Insulation Co., Inc.*[1] focused on the issue of waiver by conduct.[2] In that case, the supreme court concluded that under the new scheme set forth in chapter 2260 of the Government Code, "a party simply cannot sue the State for breach of contract absent legislative consent under Chapter 107. Compliance with Chapter 2260, therefore, is a necessary step before a party can petition to sue the State."[3]

The Texas Supreme Court adopted a consistent approach in 2002 in *Texas Natural Resource Conservation Commission v. IT-Davy.*[4] The issue presented in the case was whether IT-Davy, a general contractor, could sue the Texas Natural Resource Conservation Commission ("TNRCC"), a state agency, for breach of contract, where IT-Davy argued that it had fully performed under its contract but the TNRCC did not fully pay for services it accepted. The supreme court concluded that merely accepting the benefits of a contract is not sufficient to establish waiver.[5] In its conclusion, the supreme court noted again its "one route to the courthouse" rule and emphasis on legislative consent.[6] However, the concurring opinion by Justice Hecht, which agrees with the conclusion reached but disagrees with the broad language used by the supreme court, contains perhaps the most significant analysis and an indication about the decisions which would follow on the issue of sovereign immunity.[7] Justice Hecht noted that he doubted "whether governmental immunity from suit for breach of contract can be applied so rigidly," but declined to decide any broader issues not presented by the facts of the case, as follows:[8]

> In his opinion for the Court in *Federal Sign v. Texas Southern University*, Justice Baker noted that there may be "circumstances where the State may waive its immunity by conduct other than simply executing a contract so that it is not always immune from suit when it contracts." In his opinion today he appears to have abandoned this

1. 39 S.W.3d 591 (Tex. 2001).
2. *Id.* at 597.
3. *Id.*
4. 74 S.W.3d 849 (Tex. 2002).
5. *Id.* at 857.
6. *Id.* at 860.
7. *Id.*
8. *Id.*

> view, stating that "allowing . . . governmental entities to waive immunity by conduct that includes accepting benefits under a contract would be fundamentally inconsistent with our established jurisprudence." He does not explain this about-face. The Court was correct in *Federal Sign*. As one example, it has long been held that the State can waive immunity by filing suit. There may be others, such as debt obligations. We need not here decide the issue for all time, any more than we needed to in *Federal Sign*.[9]

In 2006, the Texas Supreme Court followed these general concepts but seemed to stop short from wholly enforcing the real waiver by filing suit concept.

A. Waiver by Filing Suit and Subsequent Developments

In 2006, the Texas Supreme Court issued its final opinion, following rehearing, in the case of *Reata Construction Corp. v. City of Dallas*.[10] The final decision clarifies Texas law that a public entity waives immunity from suit by filing its own claims in a court of law, but only to the monetary sum claimed as damages in the public entity's claim.[11]

In its first decision, issued in 2004, the Texas Supreme Court affirmed earlier case law regarding waiver of the sovereign immunity doctrine as a result of a public entity's decision to invoke the jurisdiction of the courts by filing claims or counterclaims. In *Reata Construction Corp. v. City of Dallas*,[12] the Texas Supreme Court concluded that a city waives its governmental immunity from suit by asserting claims for affirmative relief in a lawsuit where it was named as a party.[13] In reversing the holding of the appellate court, the supreme court declared as follows:

> To the extent the City enjoyed governmental immunity from suit with regard to Reata's claims, the City waived that immunity by intervening in the lawsuit and asserting claims for damages against Reata. Therefore, the trial court had subject matter jurisdiction over Reata's claims against the City, and the court of appeals erred in dismissing them.[14]

The Texas Supreme Court's holding in the original *Reata* was completely consistent with the discussion by Justice Hecht in *IT-Davy*, as well as consistent with an established line of authority recognizing that where the state invokes the jurisdiction of a court by filing suit, it waives immunity from suit for any claim that is "incident to, connected with, arises out of, or is germane to the suit or controversy brought by the State."[15]

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9. *Id.* at 860-61 (J. Hecht, C.J. Phillips, J. Owen, J. Jefferson, concurring in judgment) (internal citations omitted).

10. 197 S.W.3d 371 (Tex. 2006).

11. *Id.* at 377.

12. 47 Tex. Sup. Ct. J. 408, 408-10 (Tex. 2004).

13. *Id.* at 409.

14. *Id.*

15. *Id.* (quoting State v. Martin, 347 S.W.2d 809, 814 (Tex. Civ. App.—Austin 1961, writ ref'd n.r.e)); *see also* Anderson, Clayton & Co. v. State, 62 S.W.2d 107, 110 (Tex. 1939).

Following its first opinion in *Reata*, the Texas Supreme Court granted rehearing to the parties. In June 2006, the supreme court withdrew its 2004 opinion and issued its new opinion.[16] The new decision essentially follows the original holding, but it clarifies that the damages recoverable by a contractor in a case where a governmental entity has asserted a claim and waived immunity from suit cannot exceed the amount of the governmental entity's claim against the contractor.[17] To make the point clear, the supreme court opened its decision with the following holding: "We conclude that the City does not have immunity from suit as to Reata's claims which are germane to, connected with, and properly defensive to the City's claims, to the extent Reata's claims offset those asserted by the City."[18]

In its decision following rehearing, the Texas Supreme Court devoted much of its discussion to the Texas legislature's role in establishing both the existence of and any waiver of immunity from suit.[19] The supreme court noted that it had generally deferred to the Texas legislature to waive immunity because—it believes—the legislature is better suited to address the conflicting policy issues involved in both the establishment and the waiver of immunity. The supreme court also devoted some time in its decision to note the importance that the legislature placed upon preserving the management of fiscal matters through the appropriations process and upon protecting the sovereign from suits for money damages.[20] In that context, the supreme court sought to balance such interests with the following discussion:

> However, if the governmental entity interjects itself into or chooses to engage in litigation to assert affirmative claims for monetary damages, the entity will presumably have made a decision to expend resources to pay litigation costs. If the opposing party's claims can operate only as an offset to reduce the government's recovery, no tax resources will be called upon to pay a judgment, and the fiscal planning of the governmental entity should not be disrupted. Therefore, a determination that a governmental entity's immunity from suit does not extend to a situation where the entity has filed suit is consistent with the policy issues involved with immunity. In this situation, we believe it would be fundamentally unfair to allow a governmental entity to assert affirmative claims against a party while claiming it had immunity as to the party's claims against it.[21]

Citing its decision from *State v. Humber Oil & Refining Co.*,[22] and *Kinnear v. Texas Commission on Human Rights*,[23] the Texas Supreme Court concluded with a narrative of its reasoning:

16. *Reata*, 197 S.W.3d at 373.
17. *Id.*
18. *Id.*
19. *Id.* at 375.
20. *Id.*
21. *Id.* at 375-76.
22. 169 S.W.2d 707, 709 (Tex. 1943).
23. 14 S.W.3d 299, 300 (Tex. 2000).

> In circumstances such as those now before us, where the governmental entity has joined into the litigation process by asserting its own affirmative claims for monetary relief, we see no ill befalling the governmental entity or hampering of its governmental functions by allowing adverse parties to assert, as an offset, claims germane to, connected with, and properly defensive to those asserted by the governmental entity . . . .
>
> Therefore, we hold that the decision by the City of Dallas to file suit for damages encompassed a decision to leave its sphere of immunity from suit for claims against it which are germane to, connected with and properly defensive to claims the City asserts. Once it asserts affirmative claims for monetary recovery, the City must participate in the litigation process as an ordinary litigant, save for the limitation that the City continues to have immunity from affirmative damage claims against it for monetary relief exceeding amounts necessary to offset the City's claims. Moreover, we see no substantive difference between a decision by the City to file an original suit and the City's decision to file its claim as an intervenor in Southwest's suit. Accordingly, when the City filed its affirmative claims for relief as an intervenor, the trial court acquired subject-matter jurisdiction over claims made against the City which were connected to, germane to, and properly defensive to the matters on which the City based its claim for damages.[24]

With regard to damages sought by a contractor in excess of the amounts sought by the City, the supreme court held that there was no waiver of immunity, and the trial court did not acquire jurisdiction, unless the legislature otherwise waived immunity in some other way.[25]

This final decision issued in 2006 by the Texas Supreme Court was a limited version of its initial decision and a reaction to the numerous voices that expressed concern about protecting governmental entities from suits that might result in monetary judgments. The doctrine announced is more limited than that in the historical cases cited by the Texas Supreme Court, and it was an effort by the supreme court to balance all of the interests before it, rather than to apply the specific waiver doctrine it had articulated in prior cases.

1. Waiver Limited to Offsetting Claims

In *Texas v. Fidelity & Deposit Co. of Maryland*,[26] the Texas Supreme Court applied its own decision from *Reata* in the context of a suit filed by the State of Texas (Department of Transportation) against a bonding company that issued the performance bond for a research and technology center. In response to the State's claims, Fidelity & Deposit Company of Maryland counterclaimed for breach of contract and other claims, based

24. *Reata*, 197 S.W.3d at 376-77.
25. *Id.* at 377.
26. 223 S.W.3d 309 (Tex. 2007).

upon the State's own actions and failures to act during construction.[27]

The Texas Supreme Court referred to its *Reata* decision as allowing adverse parties to assert "as an offset, claims germane to, connected with, and properly defensive to those asserted by the governmental entity."[28] The supreme court recited that the State filed claims for damages on the performance bond and that it would have no immunity against counterclaims sufficiently related to that bond enforcement claim.[29] The supreme court was also careful to point out that the State retained immunity from suit "to the extent that Fidelity's damages exceed amounts offsetting TxDOT's monetary recovery."[30] The supreme court concluded its discussion by stating that a court must both specify the claims that arise from the State's suit and limit any recovery to an offset when determining the scope of waiver.[31]

2. *Reversing a City's Waiver by Filing Suit*

In *City of Dallas v. Martin*,[32] the Dallas Court of Appeals was faced with the question of the legal effect of a non-suit of a counterclaim by a city. The suit arose out of claims by groups of police, firefighters, and rescue forces seeking damages based upon an allegation that the City breached its contracts with them by raising pay to the highest ranking officers without making corresponding increases to lower ranks.[33] The City filed counterclaims for alleged overpayment of salaries. The City filed a plea to the jurisdiction arguing that the plaintiffs' claims were barred by immunity. On a motion for rehearing, which followed issuance of the Texas Supreme Court's final order in *Reata*, the Dallas Court of Appeals assumed—without deciding—that the City's decision to bring counterclaims waived its immunity from suit to the extent set forth in *Reata*. The court then decided, relying again on *Reata*, that the City's decision to dismiss its counterclaims reinstated its immunity.[34]

The Dallas Court of Appeals reached its decision by focusing on the portion of the *Reata* discussion that a party's claims function essentially as an offset against a claim the government makes. In this discussion, the court noted that "[b]ecause the City's waiver of immunity by filing counterclaims in these cases was limited to a determination of whether it could recover any of the amounts it alleged it was owed, the trial court's jurisdiction was necessarily dependent upon the continued existence of the City's counterclaims."[35] The court therefore concluded that once the City dismissed its affirmative claims, the officers' claims for damages

27. *Id.* at 310.
28. *Id.*
29. *Id.* at 310-11.
30. *Id.* at 311.
31. *Id.*
32. 214 S.W.3d 638 (Tex. App.—Dallas 2006, pet. denied).
33. *Id.* at 642.
34. *Id.* at 643.
35. *Id.*

were no longer "germane to" or "connected with" or "properly defensive of" any claims made by the City. Because they could not serve as an offset against the City's claims, the court concluded that they could not fall within the limited waiver described in *Reata*.[36]

The court then found that the proper course was to remand the claims to the trial court for determination of how the statutory waiver provisions affected the breach of contract claims. Finally, the court permitted the declaratory judgment action to proceed because the request for relief was limited to declaring the rights, status, and legal relationship of the parties under the ordinance.[37]

The decision can certainly be criticized as result oriented because of the scope of claims asserted against the City. The damages sought are characterized in amounts that could likely bankrupt the City of Dallas. The court of appeals was certain to point out the other ways that claims could possibly survive, although granting a plea to the jurisdiction on the main case.[38] In addition, the court of appeals did not discuss earlier decisions which hold that waiver cannot be undone by subsequent acts.

B. No Waiver by Terms of Local Government Code

In *Tooke v. City of Mexia*,[39] the Texas Supreme Court resolved the long-standing question of whether the language in a city charter that a city may "sue and be sued" and "plead and be impleaded" unambiguously waives immunity from suit.[40] In that decision, the supreme court adopted the minority view of the various Texas courts of appeals, and overruled an earlier Texas Supreme Court case by concluding that the language does not, in and of itself, constitute an unambiguous waiver.[41]

The Texas Supreme Court began its discussion of the issue by noting that scores of Texas statutes contain the language "sue and be sued" and "plead and be impleaded," that the import of such phrases cannot be ascertained apart from the context in which they occur, and that they are therefore not unambiguous.[42] Accordingly, the supreme court concluded that those words do not themselves waive immunity from suit.[43]

In various cases that were already pending before courts of appeals at the time that the *City of Mexia* case was issued, including *Olympic Waste Services v. City of Grand Saline*,[44] *City of Dallas v. Martin*,[45] and *SE Ranch Holdings, Ltd. v. City of Del Rio*,[46] the courts followed and

36. *Id.*
37. *Id.* at 644.
38. *Id.* at 643.
39. 197 S.W.3d 325 (Tex. 2006).
40. *Id.* at 342.
41. *Id.*
42. *Id.* at 328-29.
43. *Id.* at 329.
44. 204 S.W.3d 496, 499 (Tex. App.—Tyler 2006, no pet.).
45. 214 S.W.3d 638, 642 (Tex. App.—Dallas 2006, pet. denied).
46. No. 04-06-00640-CV, 2007 WL 2428081, at *4 (Tex. App.—San Antonio 2007, Aug. 29, 2007, pet. denied).

adopted the *City of Mexia* rule, finding no waiver strictly as a result of language in a city charter.

C. No Waiver by Terms of Transportation Code

In *Metropolitan Transit Authority v. M.E.B. Engineering, Inc.*,[47] the Texas Supreme Court made it clear that its holding in *City of Mexia*, regarding the meaning of "sue and be sued" clauses, applied equally under the Transportation Code.[48] Citing its earlier decision, the supreme court determined that the "sue and be sued" language of section 451.054 of the Transportation Code is not alone a clear and unambiguous waiver of immunity.[49]

D. Express Waiver by Statute for Breach of Contract

During the 2005 legislative session, and in response to the large number of legal disputes that resulted from the issue of waiver of immunity by a public entity in the context of construction projects, the legislature adopted measures to allow suits against a contracting governmental entity. Section 271 of the Local Government Code sets out the specific provisions allowing suit.

During late 2006 and 2007, quite a few cases addressing the scope and application of the statute reached the courts of appeals. Those cases address various aspects of the statute, including the scope of waiver and damages available.

Section 271.152 contains the scope of waiver, set forth as follows:

> A local governmental entity that is authorized by statute or the constitution to enter into a contract and that enters into a contract subject to this subchapter waives sovereign immunity to suit for the purpose of adjudicating a claim for breach of the contract, subject to the terms and conditions of this subchapter.[50]

Section 271.153 limits the amounts of awards as follows:

> (a) The total amount of money awarded in an adjudication brought against a local governmental entity for breach of a contract subject to this subchapter is limited to the following:
>
> (1) the balance due and owed by the local governmental entity under the contract as it may have been amended, including any amount owed as compensation for the increased cost to perform the work as a direct result of owner-caused delays or acceleration;
>
> (2) the amount owed for change orders or additional work the contractor is directed to perform by a local governmental entity in connection with the contract; and

47. 201 S.W.3d 692 (Tex. 2006).
48. *Id.* at 692.
49. *Id.*
50. Tex. Loc. Gov't Code Ann. § 271.152 (Vernon 2005 & Supp. 2008).

(3) interest as allowed by law.

(b) Damages awarded in an adjudication brought against a local governmental entity arising under a contract subject to this subchapter may not include:

(1) consequential damages, except as expressly allowed under Subsection (a)(1);

(2) exemplary damages; or

(3) damages for unabsorbed home office overhead.[51]

Section 271.154 provides that adjudication stated in the contract are enforceable procedures, including requirements to engage in alternative dispute resolution before suit, except to the extent they conflict with the statute.[52] Additional sections of the statute provide that there is no waiver of immunity from suit in federal court or for tort liability.[53] Finally, attorney's fees incurred by the local governmental entity or any other party in the adjudication of a claim by or against a governmental entity are not awarded unless a written agreement authorizes such an award.[54]

1. *Recovery of Extra Costs as Breach of Contract Damages*

In *City of Houston v. Allco, Inc.*,[55] the Houston Court of Appeals was faced with the question of what elements of damages a contractor was authorized to recover in the context of a contract written ten years before the statute took effect.[56] In its decision, the court confirmed that the City's immunity from suit was waived by the City's action in entering the construction contract, even though the contract pre-dated the statute.[57] The court also awarded extra costs for work under a provision in the contract that allowed such payments when the extra costs related to the City's failure to furnish information.[58] Finally, the court allowed the contractor to recover attorneys' fees incurred in defending a federal restraining order relating to the work, finding that the fees were not fees incurred in the adjudication of the claim (as referenced in section 271.159), rather that the fees were direct costs under the contract.[59]

2. *Claim of Waiver by Third-Party Beneficiary*

The new statute provides that waiver of immunity exists for the purpose of determining a breach of contract entered by a governmental entity.[60] At least by implication, the statute implies that parties to the

51. *Id.* at § 271.153.
52. *Id.* at § 271.154.
53. *Id.* at §§ 271.156-157.
54. *Id.* at § 271.159.
55. 238 S.W.3d 849 (Tex. App.—Houston [1st Dist.] 2007, pet. denied).
56. *Id.* at 853.
57. *Id.*
58. *Id.* at 853-54.
59. *Id.* at 854-55.
60. TEX. LOC. GOV'T CODE ANN. § 271.152 (Vernon 2005 & Supp. 2008).

contract are those with standing to assert the waiver issue. In *City of Pasadena v. Crouch/KST Enterprises, Ltd.*,[61] a non-party to a construction contract with the City claimed third-party beneficiary status in order to argue for the application of the waiver.

The facts in the case involved a contract between the City and Kinsel Industries as contractor for the construction of a wastewater treatment plant.[62] Kinsel entered into a subcontract with Crouch for electrical work. Crouch alleged it encountered numerous delays in the project as a result of Kinsel's failure to schedule work properly. Crouch filed suit against Kinsel and its surety seeking to recover its expenses incurred from the delay. Kinsel filed a motion for leave to designate the City as a responsible third party. Crouch then amended its pleading to assert a breach of contract claim against the City, arguing that it was a third-party beneficiary to the prime contract. The City filed a plea to the jurisdiction which was denied by the trial court.[63]

In its discussion, the court was careful to point out that the prime contract was a contract subject to section 271 of the Property Code because it was a written contract stating the essential terms of the agreement for providing services to a local governmental entity.[64] In the context of that discussion, the court assumed—without deciding—that a third-party beneficiary to such a contract may invoke the waiver of immunity under section 271.152, and then examined the facts associated with Crouch.[65]

Crouch argued it was a third-party beneficiary because "(1) the Subcontract incorporated the provisions of the Prime Contract and (2) the Prime Contract was intended to benefit Crouch."[66] The court noted that an intention to confer a direct benefit on a third party in a contract must be clearly and fully spelled out in the contract and that the presumption is against, not in favor of, a finding of third-party beneficiary status.[67] After reviewing the lengthy prime contract, the court concluded that it could not determine that "the Prime Contract clearly and fully spell[ed] out an intent on behalf of the City and Kinsel to confer a direct benefit upon Crouch."[68] The court also determined that absent third-party beneficiary status, Crouch could not assert a claim for breach of contract against the City and could not invoke the waiver of immunity under section 271.152.[69]

61. No. 01-07-00133-CV, 2007 WL 2214895 (Tex. App.—Houston [1st Dist.] Aug. 2, 2007, no pet.)
62. *Id.* at *1.
63. *Id.*
64. *Id.* at *3.
65. *Id.*
66. *Id.*
67. *Id.* at *9-10.
68. *Id.* at *4.
69. *Id.*

3. No Consequential Damages

In *Olympic Waste Service v. City of Grand Saline*,[70] the Tyler Court of Appeals analyzed a breach of contract claim under section 271.152 of the Local Government Code.[71] Because the type of damages sought in the breach of contract claim against the City was lost profits, which constituted consequential damages, the court of appeals determined that immunity was not waived because section 271.153 does not permit recovery for consequential damages in section 271.152 breach of contract claims.[72]

The court also concluded that no declaratory judgment action could be sought against the City regarding the issue of termination.[73] The Tyler Court of Appeals reached that conclusion because it found that section 271.152 does not mention declaratory judgment as a cause of action permitted by the statute.[74] While it is true that section 271.152 does not mention declaratory judgment, it does not do so because it is not necessary. Actions for declaratory judgment have always been permitted against public entities so long as the relief sought is not a judgment for money damages.[75]

4. No Claims Based Upon Equitable Theories

In *H&H Sand and Gravel, Inc. v. City of Corpus Christi*,[76] the Corpus Christi Court of Appeals reviewed the question of whether a material supplier could sustain claims against the City absent a contractual relationship. H&H originally pleaded that it contracted with Suntide to provide sand for a city project. Suntide failed to pay H&H, and the companies executed an alleged assignment to resolve the issue. The agreement required that Suntide would have joint checks made to Suntide and H&H until the old balance was satisfied. H&H alleged that the agreement was delivered to the City when signed and that the City was put on notice that the City's contract with Suntide had been modified. The City continued to pay only Suntide.[77]

H&H then sued the City, Suntide, and other parties for breach of contract, fraud, and other causes of action.[78] H&H's claims against the City were breach of contract, constructive trust, negligence, and quantum meruit. The City filed a plea to the jurisdiction. During a first interlocutory appeal, the court of appeals upheld the plea to the jurisdiction. On remand, H&H added claims against the City for novation, estoppel, waiver, waiver by acceptance of materials, and detrimental reliance, premised

70. 204 S.W.3d 496 (Tex. App.—Tyler 2006, no pet.).
71. *See* TEX. LOC. GOV'T CODE ANN. § 271.152 (Vernon 2005 & Supp. 2008).
72. *Olympic Waste*, 204 S.W.3d at 500; *see also id.* at § 271.152.
73. *Olympic Waste*, 204 S.W.3d at 500.
74. *Id.*
75. *See, e.g.*, Tex. Natural Res. Comm'n v. IT-Davy, 74 S.W.3d 849, 855 (Tex. 2002).
76. No. 13-06-00677-CV, 2007 WL 3293628 (Tex. App.—Corpus Christi, Nov. 8, 2007, pet. denied) (mem. op.).
77. *Id.* at *1.
78. *Id.*

upon a pass-through type of argument.[79]

On appeal, the court upheld the plea to the jurisdiction.[80] The court found that the theories of estoppel, waiver, and detrimental reliance were based in equity and were not enumerated in section 271.152's limited waiver of immunity.[81] In terms of the pass-through claims, the court held that H&H, because it was not a contractor, could not bring a pass-through type of claim.[82]

5. *Specificity of Damages Required*

In *SE Ranch Holdings, Ltd. v. City of Del Rio*,[83] the San Antonio Court of Appeals analyzed the specificity required in the pleadings of a party claiming waiver of immunity under section 271.152 while filing suit. In that case, a developer began negotiations with the City of Del Rio to develop a master plan community on 3,200 acres. The City passed an ordinance creating a zone in the area and passed a resolution authorizing the execution of a development agreement. The parties signed the development agreement, and the developer purchased the subject land. The City later repealed the ordinance, and the developer filed suit.[84]

The City argued that SE Ranch could not sustain any claim within the provisions of section 271.152 because the developer had never actually provided any goods or services to the city in light of the "suspended" contract.[85] The City also argued that there could never be any "balance due and owed" by the City, referring to the damages defined in the statutes as the "balance due and owed by the local governmental entity under the contract."[86]

The court found that it was limited to reviewing the pleadings on file to determine whether immunity existed. The third amended petition on file did not specify the nature or amount of damages it was seeking but merely stated that the City waived immunity by entering into the Development Agreement.[87] SE Ranch requested actual, consequential, and incidental damages in excess of the jurisdictional limits, but the court found that such a broad pleading was not sufficient to allege allowable damages under section 271.153 and did not establish that jurisdiction existed.[88]

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79. *Id.*

80. *Id.* at *4.

81. *Id.* at *3.

82. *Id.* at *4.

83. No. 04-06-00640-CV, 2007 WL 2428081 (Tex. App.—San Antonio Aug. 29, 2007, pet. denied) (mem. op., not designated for publication).

84. *Id.* at *1.

85. *Id.* at *4.

86. *Id.*

87. *Id.* at *5.

88. *Id.* at *12.

III. CONSTRUCTION DEFECTS AND INSURANCE COVERAGE

After many years of inconsistent decisions by various state and federal courts, the Texas Supreme Court has definitively answered the question of whether an alleged construction defect can qualify as an "occurrence" and trigger an insurer's duty to defend and/or duty to indemnify in favor of an insured contractor. Many of the state court decisions discussed in the 2006 and 2007 Survey articles were the subject of appeals pending before the supreme court when it issued its decision answering three certified questions referred by the Fifth Circuit Court of Appeals. In a six to three decision, the supreme court held that construction defects and resulting damage can trigger a duty to defend under a CGL policy.

A. THE DUTY TO DEFEND ALLEGED CONSTRUCTION DEFECTS

In *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*,[89] the Texas Supreme Court concluded that, in a case based upon alleged faulty new home construction, the insurer for the builder had a duty to defend allegations of unintended construction defects.[90] The Fifth Circuit had submitted three certified questions for answer by the supreme court, in light of the conflicting authority among the courts of appeals:

> 1. When a homebuyer sues his general contractor for construction defects and alleges only damage to or loss of use of the home itself, do such allegations allege an "accident" or "occurrence" sufficient to trigger the duty to defend or indemnify under a CGL policy?
>
> 2. When a homebuyer sues his general contractor for construction defects and alleges only damage to or loss of use of the home itself, do such allegations allege "property damage" sufficient to trigger the duty to defend or indemnify under a CGL policy?
>
> 3. If the answers to certified questions 1 and 2 are answered in the affirmative, does Article 21.55 of the Texas Insurance Code apply to a CGL insurer's breach of the duty to defend?[91]

The Texas Supreme Court answered all three questions in the affirmative, although it did not reach the question of duty to indemnify.[92]

Homeowners who purchased a new home from Lamar Homes had problems they attributed to defects in the foundation. They sued Lamar and its subcontractor regarding the defects. Lamar sent the case to its CGL insurer, seeking a defense and indemnification. Mid-Continent refused. After the federal district court granted summary judgment for Mid-Continent, the Fifth Circuit requested that the Texas Supreme Court resolve the question.[93]

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89. 242 S.W.3d 1 (Tex. 2007).
90. *Id.* at 4.
91. *Id.*
92. *Id.* at 4-5.
93. *Id.* at 5.

Noting that the CGL policy required the carrier to defend a claim for "property damage" caused by an "occurrence," the supreme court focused on those terms. The supreme court noted the policy's definition of "occurrence," as "'an accident, including continuous or repeated exposure to substantially the same general harmful conditions.'"[94] The supreme court also noted the definition of "property damage" as "'[p]hysical injury to tangible property, including all resulting loss of use of that property.'"[95]

The supreme court analyzed both terms and certified questions one and two together.[96] Mid-Continent argued that CGL coverage does not apply to defective construction that injures only the work of the contractor because the policy's purpose is to protect from tort liability, not claims of defective performance under a contract, and that defective work is not an occurrence because it is not accidental.[97] The carrier also argued that the damages sought were repairs to the home and that those damages were direct economic damages.

In response, the supreme court focused on the definition of "occurrence" and distinguished the carrier's arguments because the definition focuses on whether the injury was intended or fortuitous, not the character of the property damaged.[98] The supreme court explained that the "determination of whether an insured's faulty workmanship was intended or accidental is dependent on the facts and circumstances of the particular case."[99] Because the complaint at issue alleged that the defective construction was a product of the builder's negligence, the supreme court found no allegation of intentional conduct.[100]

Turning to the question of property damage, the supreme court noted that, on its face, the definition did not exclude the contractor's work because the resulting home and components were "tangible property."[101] The supreme court did acknowledge the existence of the exclusions in the policy, including the "your work" exclusion, but found that neither the exclusions nor the economic loss rule would preclude a conclusion that property damage could exist.[102]

B. Prompt Payment Provisions

In the third certified question of *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, the Texas Supreme Court concluded that the prompt payment provisions of section 21.55 of the Texas Insurance Code (later recodified in sections 542.051 through 542.061 of the Texas Insurance Code)

94. *Id.* at 6.
95. *Id.*
96. *Id.* at 5.
97. *Id.* at 7.
98. *Id.* at 9.
99. *Id.*
100. *Id.*
101. *Id.* at 10.
102. *Id.* at 10-12.

apply to an insurer's failure to defend.[103]

The relevant portion of the statute provides that an insurer who is "liable for a claim under an insurance policy" and who does not promptly respond to, or pay, the claim as required, is liable to the policyholder for the amount of the claim and for interest computed at eighteen percent a year as damages, as well as attorney's fees.[104] The term "claim" is defined as a first party claim "made by an insured or policyholder under an insurance policy or contract or by a beneficiary named in the policy or contract [that] must be paid by the insurer directly to the insured or beneficiary."[105] The supreme court noted that the statute does not define the term "first party claim," and that Texas courts are divided on its meaning.[106]

The Texas Supreme Court elected to follow the line of cases that have held that an insured's claim for defense costs is a first party claim because it concerns a direct loss to the insured and the claim does not belong to a third party.[107] The supreme court noted that its decision was based upon its conclusion that viewing the claim for a defense as a first party claim would reflect the legislature's purpose in enacting the prompt-payment statute.[108]

IV. CLAIMS ON PERFORMANCE BONDS AND PAYMENT BONDS

During 2006 and 2007, Texas courts considered a variety of questions concerning performance bonds and payment bonds, particularly the degree to which strict compliance with statutes is required to perfect and enforce a bond claim.

A. FOR THE MCGREGOR ACT, THE 15TH MEANS THE 15TH, NOT THE NEXT BUSINESS DAY

In *Suretec Insurance Co. v. Myrex Industries,*[109] the Beaumont Court of Appeals made it clear that, in order to file a timely claim under the McGregor Act, a notice must be mailed by the 15th of the month, and no counting rule extends that time to the next business day.

The sole issue for the appeal was the timeliness of the mailed notice provided pursuant to chapter 2253 of the Texas Government Code ("the McGregor Act").[110] Section 2253.041 of the McGregor Act provides that a notice must be provided to the prime contractor and the surety, and must be mailed on or before the 15th day of the third month after each

103. *Id.* at 5.
104. TEX. INS. CODE ANN. § 542.060 (Vernon 2008).
105. *Id.* at § 542.051(2).
106. *Lamar Homes*, 242 S.W.3d at 16.
107. *Id.* at 17.
108. *Id.*
109. 232 S.W.3d 811, 815 (Tex. App.—Beaumont 2007, pet. denied).
110. *Id.* at 812-13.

month in which any of the claimed labor and material was provided.[111]

Suretec, the surety that issued the bond in question, argued that section 2253.041(b) of the Government Code required that the subcontractor mail the required notice no later than "Sunday, May 15, 2005, which was the 15th day of the third month after the month in which the claimed labor was performed."[112] The subcontractor argued that section 311.014 of the Texas Government Code ("the Code Construction Act") extended the deadline for filing a notice of a claim where it provides that if the last day of any period is a Saturday, Sunday, or legal holiday, the period is extended to the next business day.[113]

The court noted that no case had addressed the Code Construction Act's applicability to section 2253 of the Government Code.[114] After reviewing cases in other contexts, the court concluded that the notice deadline in section 2253.041 specifically and clearly requires mailing on or before the 15th day of a month certain, and that the deadline will always fall on the 15th of a month.[115] Because the statute sets a specific deadline, rather than referring to a computation of a period of days, the court determined that the Code Construction Act does not apply to a notice under the McGregor Act.[116]

B. Exclusive Remedy for Subcontractors

In *Scoggins Construction Co. v. Dealers Electrical Supply*,[117] the Corpus Christi Court of Appeals reaffirmed that the McGregor Act is the exclusive remedy for subcontractors and suppliers on bonded public projects. The supplier argued that the McGregor Act was not the exclusive remedy, but the court held that because the project was bonded in accordance with the McGregor Act, the supplier could not seek recovery under Chapter 162 of the Texas Property Code (the "Trust Fund Act").[118] In particular, the court held that, on such a project, "a claimant may only recover on the validly executed bond itself in both the private and public contexts."[119] The supplier argued that the Trust Fund Act allowed claims against owners and contractors, even if the project was bonded.[120] But the court found that allowing a supplier to seek a remedy under the Trust Fund Act would potentially subject contractors to potential liability under both Acts, a result "contrary to the intent of the legislature,"[121] and would "eviscerate the payment bond provision of the McGregor

111. Tex. Gov't Code Ann. § 2253.041(a), (b) (Vernon 2000).
112. *Suretec*, 232 S.W.3d at 813.
113. *Id.*; *see also* Tex. Gov't Code Ann. § 311.014 (Vernon 2005 & Supp. 2008).
114. *Suretec*, 232 S.W.3d at 813.
115. *Id.* at 815.
116. *Id.*
117. No. 13-06-368-CV, 2007 WL 4442544, at *4 (Tex. App.—Corpus Christi Dec. 20, 2007, pet. denied) (mem. op.).
118. *Id.*
119. *Id.* at *5.
120. *Id.*
121. *Id.* at *7.

Act."[122]

C. Attempted Compliance with Property Code

New AAA Apartment Plumbers, Inc. v. DPMC-Briarcliff, L.P.[123] reviewed the requirements of section 53.211 and section 53.202 of the Property Code and the attempted compliance with the requirements in a particular bond. The Houston Court of Appeals found that the omission of the language from section 53.202(5), that the bond must be "'conditioned on prompt payment . . . not exceeding 15 percent of the contract price'" was not fatal, and that the bond substantially complied with the Property Code and protected the property from liens.[124]

V. ARBITRATION CLAUSES AND RIGHTS

During 2006 and 2007, Texas courts continued to issue decisions concerning arbitration provisions, including through interpretation and application of the Texas Supreme Court's 2002 and 2003 decisions. During 2002 and 2003, the Texas Supreme Court handed down three separate decisions upholding arbitration limits. In *Callahan & Associates v. Orangefield Independent School District*,[125] the supreme court outlined the extremely limited authority which any trial court or appeals court has in reviewing an arbitration award. In *CVN Group, Inc. v. Delgado*,[126] the supreme court emphasized the binding nature of arbitration and refused to reverse an arbitrator's award, even though a court of appeals found that the award was erroneous under Texas law. In *In re First Texas Homes, Inc.*,[127] the Texas Supreme Court strictly enforced the scope of an arbitration agreement between the parties to a construction contract.

A. Mandamus Proceedings on Arbitration Clauses

In *In re D. Wilson Construction Co.*,[128] the Texas Supreme Court resolved ongoing court of appeals confusion concerning whether those courts have jurisdiction to hear interlocutory appeals based on a denial of a motion to compel arising out of the Texas Arbitration Act ("TAA") when the Federal Arbitration Act ("FAA") is also implicated. In addition, the supreme court found that an arbitration clause incorporated by reference was valid and enforceable against the parties.[129] Finally, the supreme court further explained the scope of waiver of arbitration rights.[130]

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122. *Id.*
123. No. 14-05-00485-CV, 2006 WL 2827275, at *2-3 (Tex. App.—Houston [14th Dist.] Oct. 5, 2006, no pet.) (mem. op.).
124. *Id.* at *4-5.
125. 92 S.W.3d 841, 844 (Tex. 2002).
126. 95 S.W.3d 234, 238-39 (Tex. 2002).
127. 120 S.W.3d 868, 870 (Tex. 2003).
128. 196 S.W.3d 774, 779-80 (Tex. 2006).
129. *Id.* at 781.
130. *Id.* at 783.

As to federal preemption, the Texas Supreme Court found that, unless application of the TAA was contrary to federal law, the courts of appeals retain jurisdiction to hear interlocutory appeals concerning a trial court's denial of a motion to compel arbitration.[131] The court of appeals had dismissed the interlocutory appeal based on a lack of jurisdiction, finding that because the contract at issue was "a 'transaction involving commerce,'" the FAA controlled.[132] The FAA does not allow for interlocutory appeals, but does allow for mandamus review of a denial of arbitration.[133] The supreme court reiterated a four-factor test to determine whether the TAA is preempted by the FAA: "The FAA only preempts the TAA if: '(1) the agreement is in writing, (2) it involves interstate commerce, (3) it can withstand scrutiny under traditional contract defenses [under state law], and (4) state law affects the enforceability of the agreement.'"[134] Thus, whether a contract affects interstate commerce is only one factor to consider—the court of appeals had considered it dispositive: "For the FAA to preempt the TAA, state law must refuse to enforce an arbitration agreement that the FAA would enforce, either because (1) the TAA has expressly exempted the agreement from coverage, . . . or (2) the TAA has imposed an enforceability requirement not found in the FAA."[135] Because neither of these conditions were met by the agreement at issue, the supreme court found that the TAA was not preempted, and therefore the court of appeals retained jurisdiction over the interlocutory appeal.[136]

The school district also claimed that the arbitration clause either did not exist or was ambiguous.[137] The contract incorporated American Institute of Architects ("AIA") Document 201, which in paragraph 4.5 contained an arbitration clause covering any claim or controversy arising out of the contract.[138] The parties had incorporated Supplementary Conditions, including clause 4.5.1.1 that provided that factual disputes arising under the contract would be determined by the school district.[139] This, said the school district, rendered the arbitration clause nugatory or, at best, ambiguous since the school district's interpretation of factual disputes was to be dispositive.[140] The trial court found that the contract was ambiguous, and the court of appeals agreed.[141]

131. *Id.* at 779-80.

132. *Id.* at 778 (citing Am. Standard v. Brownsville Indep. Sch. Dist., Nos. 13-04-184-CV, 13-04-333-CV, 2005 WL 310777, at *2 (Tex. App.—corpus Christi Feb. 10, 2005, pet. granted) (mem. op., not designated for publication).

133. *See* Jack B. Anglin Co. v. Tipps, 842 S.W.2d 266, 272 (Tex. 1992).

134. *Id.* at 780 (citing *In re* Nexion Health at Humble, Inc. 173 S.W.3d 67, 69 (Tex. 2005)).

135. *Id.*

136. *Id.*

137. *Id.* at 781.

138. *Id.* at 777.

139. *Id.* at 781-82.

140. *Id.* at 782.

141. *Id.* at 781.

The Texas Supreme Court, however, reversed and rendered judgment for the subcontractors, holding that the arbitration clause was neither nugatory nor ambiguous: "Innumerable contracts are consummated every day in Texas that incorporate other documents by reference. A contractual term is not rendered invalid merely because it exists in a document incorporated by reference, . . . and we agree with the court of appeals that arbitration-related language is no exception to this rule."[142] The supreme court also rejected the school district's argument that the arbitration clause was ambiguous, finding that application of the arbitration clause would not render the supplemental conditions language moot because there are some situations in which arbitration would solely involve factual disputes.[143]

Finally, the supreme court addressed the school district's argument that the subcontractors had waived their rights to insist on arbitration by filing cross-actions for indemnity against the school district in a separate personal injury suit filed by students and teachers injured when the school ceiling fell.[144] The school district argued that the subcontractors had substantially invoked judicial process before insisting on arbitration, thereby waiving their right to arbitrate. The supreme court disagreed, finding that the school district failed to show that cross-actions, filed in a separate suit, worked to the school district's detriment such that it should not be compelled to arbitrate the claims in the suit at bar.[145]

B. Deletion or Omission of Arbitration Clause

In *In re Premont Indep. School District*[146] the San Antonio Court of Appeals considered whether the trial court abused its discretion by staying proceedings pending arbitration when the parties had deleted section 4.5 of the AIA Document A201 contract. In this case, the school district had contracted with Braselton Construction Company "for renovations and additions to the Premont Elementary, Junior High School and High School."[147] Finding that the project was not going to be completed on time, the school district hired a construction management company to assist with administration of the project. Ultimately, the school district filed suit against both the contractor and the management company.[148] The contractor asserted a contractual right to arbitration and the trial court granted the contractor's motion to compel arbitration, thereby ordering all of the parties to arbitrate.[149]

The school district appealed, claiming that the trial court abused its discretion in ordering it to arbitrate its claims against the management

142. *Id.* at 781-82.
143. *Id.* at 782.
144. *Id.* at 783.
145. *Id.*
146. 225 S.W.3d 329, 333-34 (Tex. App.—San Antonio 2007, pet. denied).
147. *Id.* at 331.
148. *Id.*
149. *Id.*

company because a valid arbitration clause did not exist between them.[150] In particular, the school district claimed that, although the parties entered into a contract that incorporated section 4.5 of the AIA Document A201 contract (the arbitration clause), the parties had adopted a supplementary condition striking that section.[151] The management company countered that the supplementary conditions were not signed and therefore, did not operate to cancel the arbitration clause.[152]

On appeal, the court of appeals applied *In re D. Wilson*[153] and found that it had jurisdiction to hear the interlocutory appeal.[154] The court went on to hold that "an arbitration agreement that is not signed may be incorporated by reference in the signed contract . . . . "Likewise, an agreement to not arbitrate that is not signed may be incorporated by reference in the signed document."[155] No clause in the parties' contract required that supplementary conditions be signed, whereas it did require contract modifications to be signed.[156] Because the supplementary conditions unambiguously provided that the arbitration clause be stricken, the court of appeals held that the trial court abused its discretion in ordering the parties to arbitrate because no valid arbitration agreement existed between the parties.[157]

C. Waiver of Arbitration Clause

In *Grand Homes 96, L.P. v. Loudermilk*,[158] the Fort Worth Court of Appeals determined that the trial court did not abuse its discretion by ordering all parties to binding arbitration even though the party requesting arbitration had not done so as to claims against Grand Homes 96. Two of the defendants in this case requested that the owners' claims against them be referred to binding arbitration as per the agreement between them.[159] The owners, during the hearing on the motion to compel, pointed out to the court that Grand Homes 96 was also a party to the warranty agreement at issue and that the owners' claims against it should also be referred to binding arbitration.[160] The trial court agreed and ordered all parties to arbitration.[161] Grand Homes 96 filed a petition for mandamus, which was denied by the court of appeals. The arbitration resulted in the arbitrator ordering that the contract between Grand Homes 96 and the owner be rescinded, and that Grand Homes 96 purchase the owners' home for $292,000. The trial court affirmed the

150. *Id.* at 331-32.
151. *Id.* at 333.
152. *Id.* at 334.
153. *In re* D. Wilson Const. Co., 196 S.W.3d 774 (Tex. 2006).
154. *Premont*, 225 S.W.3d at 332-36.
155. *Id.* at 334.
156. *Id.*
157. *Id.* at 335-36.
158. 208 S.W.3d 696, 698-99 (Tex. App.—Fort Worth 2006, pet. denied).
159. *Id.* at 699-700.
160. *Id.* at 700.
161. *Id.*

award.[162]

On appeal, Grand Homes 96 contended that the trial court erred by compelling arbitration of the owners' claims when the owners had not filed a motion to compel those claims, instead, the other defendants had.[163] In addition, Grand Homes 96 claimed that the owners' failure to file a motion to compel deprived them of their ability to "present defenses to arbitration and to object to the court's appointment of an arbitrator."[164] The court of appeals held that the trial court had jurisdiction to order the parties to arbitration, notwithstanding the owners' failure to request the arbitration in a motion to compel, citing to Texas Civil Practice and Remedies Code section 171.021(a), which requires only that a motion to compel be filed by "a party."[165]

The court of appeals went on to consider Grand Homes 96's argument that it was deprived of the opportunity to raise defenses to arbitration because it had no notice that those claims were on the table for arbitration when the trial court issued its order compelling all parties to arbitrate.[166] In particular, Grand Homes 96 argued it was unable to present its defense of waiver to the trial court.[167] Following United States Supreme Court precedent, the court of appeals held that Grand Homes 96 had the opportunity to raise its waiver defense to the arbitrator, and therefore, Grand Homes 96 was not harmed by its unpreparedness to raise the defense to the trial court.[168]

Waiver is a question of law, and the court of appeals reviewed the issue *de novo*.[169] The court held that the owners did not waive their right to arbitrate their claims against Grand Homes 96, pointing out the strong presumption against waiver: "Courts will not find that a party has waived its right to enforce an arbitration clause by merely taking part in litigation unless it has substantially invoked the judicial process to its opponent's detriment."[170] The only action the owners took was to request that the trial court compel arbitration once the other defendants were successful in compelling arbitration of the owners' claims.[171] In addition, because the case was only eight months old and very little discovery had taken place, Grand Homes 96 could not meet its burden of demonstrating that it was prejudiced by the owners' actions.[172] Significantly, the court of appeals rejected Grand Homes 96's request that the court adopt the holding of the Austin Court of Appeals in *Vireo P.L.L.C. v. Cates*, which stated: "after a plaintiff files suit, '[i]f the defendant does not insist upon

162. *Id.*
163. *Id.* at 701.
164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.* at 702-03.
168. *Id.* at 703.
169. *Id.*
170. *Id.* at 704.
171. *Id.*
172. *Id.*

arbitration, the contracting parties have mutually repudiated the arbitration covenant as a matter of law and waived any right thereunder.'"[173] The court held that this holding was inappropriate for a multi-defendant lawsuit, where the plaintiff could be forced to both litigate and arbitrate, depending on the choices of the defendants.[174]

D. Review and Enforcement of Arbitration Award

1. Limited Grounds for Vacation of Award

The defendant in *Grand Homes 96, L.P. v. Loudermilk,* also challenged the appointment of the arbitrator by the trial court, claiming that it had the contractual right "to select an arbitrator or to have one appointed by the American Arbitration Association."[175] After the order to compel was entered, the owners filed a motion to set aside the trial court's first choice of an arbitrator. The motion was served on Grand Homes 96, but it did not respond to the motion or file its own. The court of appeals held that Grand Homes 96 waived its right to challenge the appointment by waiting until after they had fully participated in the arbitration and had an adverse award against it.[176]

Grand Homes 96 also argued that "the arbitrator exceeded her authority by granting remedies outside of the warranty's scope, disregarding the law of limitations, and miscalculating the rescission damages." The owners countered that, because of the lack of a record of the proceedings, deference had to be shown to the arbitrator's award.[177]

The court began by stating that, in Texas, review of an arbitration award is extraordinarily narrow and that a "mere mistake of law or fact" does not allow a court of appeals to set the award aside.[178] The court also agreed with the owners that, absent a transcript of the proceedings, the court must presume that the arbitrator's reasoning and the evidence were adequate to support the award.[179] But an appellate court can vacate an arbitration award if there is "a statutory or common law ground" to do so.[180] One of the statutory grounds is that the arbitrator exceeded its power, which is derived from the arbitration agreement and is limited to a decision of the express or implied matters submitted therein.[181] Unfortunately for Grand Homes 96, because the owners' pleadings prayed for rescission and the other damages awarded by the arbitrator, Grand Homes 96's argument that the arbitrator exceeded her authority was

173. *Id.* (citing Vireo P.L.L.C. v. Cates, 953 S.W.2d 489, 491 (Tex. App.—Austin 1997, pet. denied)).
174. *Id.* at 704.
175. *Id.* at 705.
176. *Id.*
177. *Id.*
178. *Id.*
179. *Id.*
180. *Id.*
181. *Id.* at 705-06.

without merit.[182]

2. Standard for Review

In *Holcim (Texas) Limited Partnership v. Humboldt Wedag, Inc.*,[183] the owner of a cement production line, Holcim brought an arbitration claim against its contractor under an arbitration clause in a turnkey agreement. Watkins, the contractor, brought a third-party claim against Humboldt, a subcontractor in the arbitration.[184] Holcim objected to the joinder of Humboldt, claiming that Humbolt was not a necessary party and that there was no arbitration agreement between itself and Humboldt.[185] Humboldt cross-claimed against Holcim for trapped funds and asked the arbitration panel to order Holcim to pay whatever it owed Watkins directly to Humboldt.[186] The arbitration panel entered an order bifurcating the proceedings and, after the first proceeding, found that Watkins did not substantially complete the project and that Holcim was entitled to damages of almost $5 million.[187] But the panel also found that Watkins' breach was not material and that Watkins was entitled to recover about $7.5 million from Holcim, leaving a balance due to Watkins of about $2.6 million.[188] Holcim then complained that there was no arbitration agreement between itself and Humboldt, and thus it should not have to pay Humboldt directly.[189] The panel disagreed, imposing a constructive trust on the $2.6 million. Humboldt moved for the district court to confirm the award, which it did, prompting Holcim to file an interlocutory appeal.[190]

The first issue the Waco Court of Appeals confronted was whether an interlocutory appeal was the correct procedural device.[191] In this case, the Federal Arbitration Act controlled the proceedings. Citing Texas Civil Practices and Remedies Code section 171.098(a), the court of appeals determined that a party seeking review of an arbitration award confirmation may do so by an interlocutory appeal, regardless of whether the arbitration occurred under the Federal Arbitration Act or the Texas Arbitration Act.[192]

In a second issue, the court determined that Holcim's petition to vacate the arbitration award was timely because it was brought within three months of the arbitration award being mailed to the parties, as required by the section 12 of the Federal Arbitration Act.[193]

182. *Id.* at 706.
183. 211 S.W.3d 796 (Tex. App.—Waco 2006, pet. denied).
184. *Id.* at 799.
185. *Id.* at 799-800.
186. *Id.* at 799.
187. *Id.*
188. *Id.*
189. *Id.* at 799-800.
190. *Id.* at 800.
191. *Id.*
192. *Id.* at 800-01.
193. *Id.* at 801-02.

Humboldt contended that Holcim could not dispute the existence of an arbitration agreement because Holcim had not sought a stay of the arbitration proceedings.[194] The court found that there is no requirement that a party file a motion to stay before it files a motion to vacate an arbitration award.[195] Humboldt relied on Texas Civil Practice and Remedies Code sections 171.023 and 171.088, but the court found no requirement that a party file a motion to stay in order to challenge an arbitration award by filing a motion to vacate.[196] Holcim had complained to the trial court that Humboldt was not a necessary party and that there was no arbitration agreement. This was sufficient for Holcim to preserve its ability challenge to the award.[197]

Humboldt further argued that "Holcim is estopped to deny that [Humboldt's] claims lie within the scope of the arbitration clause [between Holcim and Watkins] because Holcim sought affirmative relief against [Humboldt] in the arbitration proceedings."[198] But the court found that Holcim had objected to consideration of Humboldt's claims:

> "Where a party objects to arbitrability but nevertheless voluntarily participates in the arbitration proceedings, waiver of the challenge to arbitral jurisdiction will not be inferred." Because Holcim initially objected to the arbitrability of [Humboldt's] claims before participating in the . . . arbitration proceedings, Holcim is not estopped to deny that [Humboldt's] claims lie within the arbitration clause.[199]

Humboldt fared no better arguing equitable estoppel.[200] Although Texas law allows a non-signatory to enforce an arbitration agreement if equity would require it, this was not the case here.[201] There are two ways that a non-signatory can compel arbitration:

> (1) when "the nature of the underlying claims requires the signatory to rely on the terms of the written agreement containing the arbitration provision in asserting its claims against the non-signatory;" and (2) "when the signatory . . . raises allegations of substantially interdependent and concerted misconduct by both the nonsignatory and one or more of the signatories to the contract."[202]

Humboldt claimed that Watkins' claims fell within (2).[203] The court, however, found equitable estoppel inapplicable where there are two *separate* claims based on two *separate* agreements, as was the case here.[204]

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194. *Id.* at 802.
195. *Id.* at 803.
196. *Id.* at 802-03.
197. *Id.* at 803.
198. *Id.*
199. *Id.* (quoting Kaplan v. First Options of Chicago, Inc., 19 F.3d 1503, 1510 (3d Cir. 1994), *aff'd*, 514 U.S. 938 (1995)).
200. *Id.* at 804.
201. *Id.* at 803-04.
202. *Id.* at 804 (quoting McMillan v. Computer Translation Sys. & Support, Inc., 66 S.W.3d 477, 482 (Tex. App.—Dallas 2001, no pet.).
203. *Id.*
204. *Id.*

Watkins had alleged that Holcim breached the turnkey agreement and that its third-party claim against Humboldt arose from Humboldt's breach of the subcontract.[205]

Finally, Humboldt argued that an arbitration agreement in fact existed between itself and Holcim because of the nature of the two contracts at issue.[206] In particular, Humboldt argued that consolidation provisions in the turnkey agreement showed that the turnkey agreement and the arbitration clause were meant to apply to claims between Holcim and Humboldt.[207] The provisions at issue provided for a right of consolidation for claims between necessary parties and subcontractors. But, the consolidation only allowed for joinder of a third party when consent was obtained by a signatory, and did not allow the third party to compel arbitration.[208] The court found that Holcim had consented to allow Watkins to bring Humboldt into the arbitration, but did not consent to arbitrate its claims with Humboldt.[209] Because the plain language of the contract evidenced Holcim's intent to arbitrate only its claims with Watkins, the trial court's denial of Holcim's motion to vacate the arbitration was reversed.[210]

3. *Manifest Disregard*

In *P. McGregor Enterprises, Inc. v. Denman Buildings Products, Ltd.*,[211] the Amarillo Court of Appeals reviewed the standard for refusing to enforce an arbitration award. The parties participated in a two-day arbitration, and at its conclusion the arbitrator found PME liable to Denman, a subcontractor for an outstanding contract balance of over $350,000, plus interest and attorneys' fees.[212] Denman sought confirmation of the award, and the trial court entered a corresponding judgment. After a hearing, the trial court overruled a motion to vacate the award.[213]

On appeal, PME argued that the trial court erred in confirming damages to Denman because PME established the federal common law ground for vacating the award: namely its argument that "a party fraudulently inducing another to enter a contract must 'disgorge' profits it obtains from the contract."[214]

In its discussion, the court referred to the fact that "manifest disregard of the law is one of the narrow grounds on which an award may be vacated under the FAA," and that "the ground requires proof of more than error or misunderstanding of the law."[215] The court noted the standard

205. *Id.*
206. *Id.* at 805.
207. *Id.*
208. *Id.* at 806.
209. *Id.*
210. *Id.*
211. No. 07-05-0385-CV, 2007 Tex. App. LEXIS 3126, *1 (Tex. App.—Amarillo Apr. 24, 2007, pet. denied).
212. *Id.* at *6-7.
213. *Id.* at *7-8.
214. *Id.* at *18.
215. *Id.*

that the "arbitrator must have 'appreciated the existence of a clearly governing principle but decided to ignore or pay no attention to it,'" and that the "law at issue must be well defined, explicit and clearly applicable."[216]

Upon its review of the case, the court of appeals found no manifest disregard.[217] The court recited that the record showed that whether the contract was fraudulently induced was a disputed issue before the arbitrator and that the arbitrator could have found, based upon the evidence submitted, that there was no fraudulent inducement.[218] Accordingly, the court determined that there were no grounds to show that the arbitrator manifestly disregarded the law.[219]

VI. MECHANIC'S & MATERIALMAN'S LIENS

A. Liens Based Upon Borrowed Labor

In *Reliance National Indemnity Co., v. Advance'd Temporaries, Inc.*,[220] the Texas Supreme Court made clear that a temporary employment agency, which provided laborers under a contract with a subcontractor, did furnish labor within the meaning of the Texas Property Code and qualified for a mechanic's lien on the property. Lamar was the general contractor for construction of certain apartments, who then subcontracted with Gonzalez Construction. Gonzalez did not have an adequate work force for the job and hired additional workers through a temporary employment agency called Advance'd Temporaries. The agreement between Gonzalez and Advance'd identified the workers as Advance'd employees. Advance'd supplied more than one hundred workers for the project.

After Lamar paid Gonzalez for the work on the project, Gonzalez apparently did not pay Advance'd. Advance'd filed its mechanic's lien affidavit for the unpaid amounts and sued both Gonzalez and the surety for Lamar. The trial court concluded that Advance'd was not entitled to a lien, and the court of appeals reversed. On appeal to the Texas Supreme Court, Lamar's surety argued that Advance'd did not "furnish labor," as used in the Texas Property Code, and that the lien was not timely perfected.

The Texas Supreme Court began its analysis by reviewing the Texas Property Code, which states that one qualifies under the lien statute as a person who "furnishes labor" if the person "labors . . . or furnishes labor or materials for construction or repair."[221] Reliance argued that Advance'd did not "furnish labor" because it did not supervise the temporary workers and was not responsible for the quality of their work. In

216. *Id.* (quoting Brabham v. A.G. Edwards & Sons, Inc., 376 F.3d 377, 381-82 (5th Cir. 2004)).
217. *Id.* at *19.
218. *Id.* at *19-20.
219. *Id.* at *20.
220. 227 S.W.3d 46 (Tex. 2007).
221. Tex. Prop. Code Ann. § 53.021(a)(1) (Vernon 2007).

addition, Reliance claimed that the personnel were Gonzalez' employees under the borrowed-employee doctrine. Reliance also argued that Advance'd did not furnish labor because it was not the employer of the temporary workers who performed the work.[222]

The supreme court disagreed with these arguments, particularly reasoning that the temporary workers were employees of Advance'd.[223] The contract at issue identified the temporary workers as employees of Advance'd and made Advance'd the responsible party for recruiting, screening, hiring, paying, and insuring them. The supreme court explained that the fact that Advance'd did not control the work at the site was not relevant because the personnel did not cease to be employees of Advance'd.[224] The supreme court found that, under these circumstances, Advance'd was no different from a supplier that furnishes materials.[225] Instead of materials, however, what was provided was labor.

B. Lien Rights on Leasehold and Proper Descriptions

In *Ibarra v. Nicholes*,[226] the Houston Court of Appeals addressed the sufficiency of a property description and the extent to which lien attached to real property rights. The commercial salon tenant sued the subcontractor, who was hired to make improvements to a retail space, for defective construction of cabinetry. The subcontractor counterclaimed for breach of contract and quantum meruit, seeking payment for materials. The subcontractor also filed a lien affidavit seeking a lien against the entire retail center property, not just the premises leased by the plaintiff salon. The salon moved for summary judgment to dismiss the counterclaims and vacate the liens. The trial court granted summary judgment in favor of the salon.[227]

In reviewing the scope of the claimed lien, the court noted that the salon challenged the validity of the lien because the subcontractor used an overly broad property description which described the entire fee estate of the shopping center.[228] The salon argued the claim was improper because the property owner for the entire center did not contract with the subcontractor for improvements to the leased space. The salon argued that, at most, the subcontractor could only claim a lien on the leased premises. The subcontractor argued that because the landlord required approval of all plans, it was the true contracting party.

The court dismissed the arguments of the subcontractor, noting the long-standing rule that a mechanic's lien attaches to the interest of the

222. *Reliance Nat'l*, 227 S.W.3d at 48-49.
223. *Id.*
224. *Id.* at 49.
225. *Id.*
226. No. 01-06-00762-CV, 2007 Tex. App. LEXIS 6197 (Tex. App.—Houston [1st Dist.] Aug. 2, 2007, pet. denied) (mem. op.).
227. *Id.* at *7.
228. *Id.* at *16.

person contracting for construction and their interest only.[229] Unless the owner of property is an actual party to the construction contract, a lien cannot attach to the fee estate.[230] The court determined that the lease requiring approval from the landlord for construction did not affect the law regarding the scope of the lien.[231]

C. Signature Requirement for Liens on Homestead Property Enforced

The Corpus Christi Court of Appeals reviewed the requirements for a lien on a homestead in *The Cadle Co. v. Ortiz*.[232] Property owners Mary and David Ortiz married in 1979, divorced in 1979, and remarried in 1989. In 1994, Mrs. Ortiz acquired a house but did not list her husband's name on the deed. The couple occupied the house as their homestead from 1994 until the time of the lawsuit. In 1996, the couple contracted for improvements to the home. Mrs. Ortiz signed a note, contract, and trust deed. Mr. Ortiz did not sign any documents. In the loan application made through HUD, Mrs. Ortiz's documents indicated that she was not married.[233]

The Ortizes defaulted on the loan some years later, and Cadle, the holder of the note, foreclosed on the property. The Ortizes filed suit for wrongful foreclosure and attorneys' fees, arguing that foreclosure was improper because a homestead exemption attached to the property. Cadle argued that the Ortizes had waived the homestead rights by committing a fraudulent misrepresentation intended to deceive creditors. The trial court invalidated the lien and declared a wrongful foreclosure.[234]

On appeal, the court of appeals explained the broad nature of the homestead right under Texas law and found that no lien right existed because of the failure to obtain the signature of both spouses.[235] The court acknowledged that a homestead right "can dissolve if the owners deliberately misrepresent their marital status in order 'to defeat the rights of an innocent party, who in good faith, without notice, for valuable consideration, has acquired valid liens.'"[236] The evidence in the case, as described by the court, was that the home was purchased during marriage and occupied as a homestead. Mrs. Ortiz signed her name on the contract and deed documentation without mentioning her husband. She did not represent herself as either married or not. Thus, the court concluded that the documentation signed only by Mrs. Ortiz was not sufficient to estab-

229. *Id.* at *17.
230. *Id.* at *18.
231. *Id.* at *18-19.
232. 227 S.W.3d 831 (Tex. App.—Corpus Christi 2007, pet. denied).
233. *Id.* at 834.
234. *Id.*
235. *Id.* at 835.
236. *Id.* (quoting Nat'l Bond & Mortgage Corp. v. Davis, 60 S.W.2d 429, 434 (Tex. 1933)).

lish a lien on homestead property.[237]

D. Content of Affidavit to Remove Lien

In *Tsertos v. Yammine,*[238] the Houston Court of Appeals analyzed whether the contents of an affidavit filed to remove a lien substantially complied with the requirements to be effective. The contractor in the case made seven draw requests, the last of which was not paid, and filed a mechanic's lien affidavit. The owner filed suit to remove the lien and proceeded with the summary motion procedure. In support of that motion, the owner filed an affidavit asserting that he complied with the Texas Property Code and paid all funds owed. The affidavit did not, however, state that the facts contained therein were true and correct. The affidavit did state that the affiant had personal knowledge of the facts.[239]

The contractor argued that it had not been paid for change orders and that the affidavit was defective based upon its failure to recite that the facts were true and correct. The court explained that "an affidavit[ ] that does not represent that the facts as disclosed in the affidavit [are] true and within the affiant's personal knowledge is legally insufficient."[240] However, the court also noted that where

> an affidavit does not specifically recite that the facts are true, but sets out that it was made on the affiant's personal knowledge and is subscribed to and sworn before a notary public, it is not defective if, when considered in its entirety, its obvious effect is the affiant is representing the facts stated therein are true and correct.[241]

The court found that while the affidavit at issue did not specifically state the facts were "true and correct," it did state that the affiant had personal knowledge of the statements made, it was sworn, and its obvious effect was a representation that the facts were true and correct.[242] Accordingly, the court considered the affidavit as effective.[243]

VII. CONSTRUCTION DISPUTES

The dispute in *Design Electric v. Cadence McShane Corp.*[244] arose from an electrical subcontractor's representation to the general contractor that substantial savings could be realized by modifying the design of a service entrance busway, which carried electricity to individual condominiums in the project. The subcontractor estimated a savings of at least

237. *Id.* at 836.
238. No. 14-06-00769-CV, 2007 Tex. App. LEXIS 8549 (Tex. App.—Houston [14th Dist.] Oct. 18, 2007, no pet. h.) (mem. op.).
239. *Id.* at *1-4.
240. *Id.* at *4.
241. *Id.* at *5.
242. *Id.* at *4-5
243. *Id.* at *5.
244. No. 14-06-00703-CV, 2007 Tex. App. LEXIS 8586 (Tex. App.—Houston [14th Dist.] Oct. 30, 2007), *vacated by, substituted opinion at, motion denied by, appeal dismissed,* 2008 Tex. App. LEXIS 469 (Tex. App.—Houston [14th Dist.] Jan. 24, 2008, no pet. h.).

$240,000–$300,000, with a potential savings of $500,000. However, the real savings totaled only $120,000–$128,000. The subcontract was credited with a figure of $300,00 in savings. When the electrical subcontractor sued under breach of contract and violation of the Prompt Payment Act theories to recover the difference between $300,000 and $120,000, along with retainage and the contract balance, the general contractor defended on several theories, including waiver, estoppel, unclean hands, and prior breach. The trial court entered judgment in favor of the general contractor on the subcontractor's breach of contract claims and on the general contractor's affirmative defenses. The trial court found that the general contractor owed the subcontractor the contract balances, but found that the subcontractor should pay attorneys' fees under section 38.001 of the Texas Civil Practices and Remedies Code, along with post-judgment interest.[245]

On appeal, the Houston Court of Appeals identified the award of attorneys' fees as the real dispute in the appeal but had to determine whether the trial court's findings in favor of the general contractor were proper in order to determine the propriety of the award of attorneys' fees.[246] Thus, the court analyzed whether the trial court's judgment was supported by the evidence, including evidence that the subcontractor had represented the $300,000 savings and failed to disclose that the savings would only be $120,000, even though the subcontractor was aware that its supplier had quoted only a $120,000 savings.[247] The court found that such concealment provided grounds for finding that the subcontractor was estopped from arguing that the savings would be less than $300,000.[248] But this did not resolve the issues.

The next question for the court was whether the subcontractor's Prompt Payment Act claim was defeated because there was a good faith dispute over the claim—the difference between the actual savings and the amount credited on the subcontract.[249] The court found that as to such an amount, the claim was disputed and the dispute was a good faith one, and therefore not subject to the Act.[250] But for those other contract amounts and retainage that were not in dispute, the court held that the Prompt Payment Act would apply. The general contractor argued that the entire amount was subject to a good faith dispute because the subcontractor had failed to fulfill what the general contractor called conditions precedent to payment, that is, documentation for the change in the busway and release of liens. But the court found that there was no language of condition precedent related to this change in the contract or to the subcontractor's liens against the owner, and therefore the subcontractor's right to the contract balance and retainage was not conditioned on such

245. *Id.* at *9-10.
246. *Id.* at *10.
247. *Id.* at *15-16.
248. *Id.* at *20-21.
249. *Id.* at *21-22.
250. *Id.* at *32.

documentation or release.[251] However, because the trial court had not issued a finding of fact on an amount attributable to the dispute over the busway, the court remanded the case for such a determination.[252]

The court also considered the subcontractor's argument that it had proven its claim for breach of contract against the general contractor as a matter of law and that there was no evidence that the subcontractor materially breached the subcontract.[253] The court found that the general contractor's vice president had admitted that the subcontractor's work was complete and that there were no deficiencies.[254] Thus, unless the contractor had an affirmative defense, the subcontractor's breach of contract claim was proven as a matter of law.[255] The contractor raised the defense of prior breach to no avail because the court had already established earlier that the subcontractor's failure to release its liens and its failure to provide specified documentation for the change in the busway were independent from the general contractor's obligation to pay for work done.[256] The court also found for the subcontractor on the general contractor's waiver and unclean hands defenses, reasoning that because of the independent nature of the obligations, the subcontractor's failures did not provide the general contractor with grounds to refuse payment.[257]

Finally reaching the real issue in this case—the award of attorneys' fees—the court found that such an award must be granted to the prevailing party, who is the party "vindicated by the trial court's judgment."[258] Because the court of appeals had found that the subcontractor had established its breach of contract claim, the court held that the trial court erred in awarding attorneys' fees to the general contractor and remanded for a consideration of whether the subcontractor met all the requirements of section 38.002 of the Civil Practices and Remedies Code.[259]

VIII. QUANTUM MERUIT

During the Survey period, both the Fourteenth Houston Court of Appeals and the Dallas Court of Appeals had the opportunity to explore some details of the theory of quantum meruit in the context of a construction dispute. The decisions discussed the elements and exceptions to that theory, as well as the relationship of substantial performance and substantial compliance to a recovery under a quantum meruit claim.

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251. *Id.* at *27-31.
252. *Id.* at *35-36.
253. *Id.* at *36-37.
254. *Id.* at *38.
255. *Id.* at *39.
256. *Id.* at *43.
257. *Id.* at *44-47.
258. *Id.* at *49.
259. *Id.* at *50-53.

A. Elements and Exceptions for Claim

In *Pepi Corp. v. Galliford*,[260] Galliford, a subcontractor, sued Pepi Corp., the owner of a restaurant, for quantum meruit. Galliford provided electrical work on the building and submitted invoices to the contractor, but did not receive payment. Galliford contacted Pepi and spoke to the president of the company, who alleged Galliford said, "I'll make sure you get paid."[261] The trial court entered judgment for Galliford on his quantum meruit claim.[262]

On appeal, Pepi argued that judgment was improper because quantum meruit is not available when a contract exists governing the subject matter of the claim. Quantum meruit recovery can be had, said the Houston Court of Appeals, when the plaintiff proves the following:

> (1) that valuable services were rendered or materials were furnished, (2) for the person sought to be charged, (3) which services and materials were accepted by the person sought to be charged, used and enjoyed by him, (4) under such circumstances as reasonably notified the person sought to be charged that the plaintiff, in performing such services, was expecting to be paid by the person sought to be charged.[263]

But absent a recognized exception, a quantum meruit claim is not available when an express contract exists that governs the party's performance.[264] The two issues on appeal were whether the fourth element was met and whether an express contract existed that barred recovery in quantum meruit.

The court of appeals first noted that the absence an express contract between the plaintiff and the party sought to be charged is not dispositive because any express contract governing performance will preclude recovery in quantum meruit: "This rule not only applies when a plaintiff is seeking to recover in quantum meruit from the party with whom he expressly contracted, but also when a plaintiff is seeking to recover 'from a third party foreign to the original but who benefited from its performance.'"[265] The determinative consideration is whether a contract covers the materials and services at issue.[266] Here, there was a contract between Galliford and the general contractor covering the materials Galliford provided on the project. Thus, unless an exception to the general rule applied, Galliford's quantum meruit claim should have been dismissed.

The Texas Supreme Court has recognized three exceptions to the bar of recovery in quantum meruit when a contract covers the performance of the plaintiff. First, if the plaintiff has partially performed, but is barred

260. 254 S.W.3d 457 (Tex. App.—Houston [14th Dist.] 2007, pet. denied).
261. *Id.* at 459.
262. *Id.*
263. *Id.* at 460.
264. *See id.* at 462.
265. *Id.* (quoting Hester v. Friedkin Cos., Inc. 132 S.W.3d 100, 106 (Tex. App.—Houston [14th Dist.] 2004, pet. denied)).
266. *Id.*

from completing performance due to the defendant's breach, quantum meruit may be available.[267] Galliford had fully performed, so this exception was not available. Second, recovery is sometimes permitted when a plaintiff partially performs an express unilateral contract.[268] The contract at issue was bilateral. The third exception, which allows quantum meruit recovery for a breaching plaintiff to a construction contract when the benefits of partial performance are accepted, was not available because Galliford did not breach.[269] In sum, because Galliford completed the contract, he could not recover in quantum meruit from the owner of the property.[270] Thus, the judgment of the trial court was reversed and a take-nothing judgment in favor of Pepi was rendered.[271]

B. Substantial Compliance Versus Substantial Performance

In *Gentry v. Squires Construction, Inc.*,[272] the construction company sued the Gentrys, claiming breach of contract and quantum meruit damages resulting from a residential construction contract entered into by the parties. The Gentrys had refused to pay Squires' final draw request, claiming numerous construction defects, including the fact that the house had been built with eight-foot ceilings, whereas the plans and contract called for ten-foot ceilings.[273] The trial court entered judgment for Squires for its reasonable costs of labor and materials under a quantum meruit theory.[274] In addition, the trial court found that the Gentrys' counterclaims were preempted by the Texas Residential Construction Liability Act ("RCLA").[275] On appeal the Gentrys challenged both rulings.[276]

The court of appeals determined that the trial court had not erred in finding that Squires could collect the reasonable value of its labor and materials under quantum meruit.[277] As noted in *Truly v. Austin*,[278] there are three ways in which a contractor can collect the reasonable value of labor and materials:

> (1) [i]f the services rendered and accepted are not covered by the contract; (2) if the contractor partially performed under the [contract,] but was prohibited from completing the contract because of the owner's breach; or (3) [if] the contractor breached but the owner accepted and retained the benefits of the contractor's partial

267. *Id.*
268. *Id.* at 462-63 (citing Truly v. Austin, 744 S.W.2d 934, 936 (Tex. 1988)).
269. *Id.* at 463.
270. *Id.*
271. *Id.*
272. 188 S.W.3d 396 (Tex. App.—Dallas 2006, no pet.).
273. *Id.* at 401.
274. *Id.* at 401.
275. *Id.* at 402.
276. *Id.*
277. *Id.* at 401.
278. 744 S.W.2d 934, 936 (Tex. 1988).

performance.[279]

The Gentrys argued that none of the three ways was available to Squires because Squires did not substantially comply with the contract.

The Dallas Court of Appeals disagreed, holding that, unlike substantial performance, which will bar recovery in quantum meruit, substantial compliance with the contract is not required for quantum meruit recovery.[280] In the instant case, there was evidence that Squires partially performed, but did not substantially perform, the contract and that the Gentrys accepted and retained the benefits of that partial performance. Thus, the trial court did not err in allowing recovery for Squires under quantum meruit.[281]

IX. THE SUBSTANTIAL PERFORMANCE DOCTRINE

During the Survey period, the appellate courts in Austin and Houston had the opportunity to address cases on the doctrine of substantial performance and its relationship to a party's ability to sue for breach of a construction agreement.

A. Substantial Performance and Damages

The dispute in *RAJ Partners, Ltd. v. Darco Construction Corp.*[282] arose from the construction of a Holiday Inn Express in Lubbock, Texas. RAJ owned the franchise to build the hotel and contracted with Darco build it. RAJ withheld the eleventh and twelfth pay applications because it believed that Darco had failed to perform as required under the contract. Darco perfected its mechanic's liens and filed suit. The trial court found for Darco on its breach of contract claim, awarding prejudgment interest, attorney's fees, and foreclosure of the mechanic's lien.[283] RAJ appealed, arguing that Darco did not substantially perform.

RAJ's theory for Darco's failure to substantially perform was based on the fact that the cost to fix Darco's construction exceeded the cost of mere remediation and that Darco failed to meet the difference-in-value measure of damages. The Austin Court of Appeals began its analysis by stating the general rule that substantial performance is an equitable doctrine that allows breaching parties to recover on a contract so long as the breaching party substantially completed their obligations.[284] RAJ argued that the brick work done by Darco had to be torn down and reconstructed. But the trial court found that the defects in the brickwork were merely aesthetic and not in need of remedy.[285] Because the brickwork was not in need of remedy, Darco did not have to prove the remedial cost

279. *Gentry*, 188 S.W.3d at 403.
280. *Id.* at 404.
281. *Id.*
282. 217 S.W.3d 638 (Tex. App.—Austin 2006, no pet.).
283. *Id.* at 643.
284. *Id.*
285. *Id.* at 644.

of the work.[286]

RAJ next argued that substantial performance was legally impossible because the reconstruction cost exceeded mere remediation.

> Case law holds there is no substantial performance "when it is necessary, in order to make the building comply with the contract, that the structure, in whole or in material part, must be changed, or there will be damage to parts of the building, or the expense of such repair will be great."[287]

However, the trial court's finding was that the defects were aesthetic in nature and did not impair the structure as a whole.[288] Thus, the defects did not render substantial performance legally impossible.[289] Because the court found that Darco substantially performed, the difference-in-value measure was inapplicable.[290] Thus, RAJ's appeal was overruled and the trial court's judgment was upheld, as modified by the court of appeals.[291]

Substantial performance was also at issue in *Hirschfeld Steel Co. v. Kellogg Brown & Root, Inc.*[292] In this case, Hirschfeld, a subcontractor, sued Kellogg for breach of contract and retainage. Hirschfeld sought declaratory judgment that it was not obligated to provide an agreed warranty on a retractable roof system for Minute Maid Park in Houston, Texas. The trial court granted summary judgment denying Hirschfeld's claims and, after a jury trial, the court rendered judgment that each party take nothing on their claims.[293] In particular, the trial court found that the declaratory judgment claim was not ripe because the facts had not developed sufficiently to find that an injury had occurred or was likely to occur.[294]

On appeal, Hirschfeld challenged the jury's findings that it did not substantially perform its warranty obligations. Hirschfeld had warranted the roof for ten years following completion, but repudiated the warranty after only one year because it claimed that routine maintenance work had not been done, thereby voiding the warranty.[295] The Houston Court of Appeals found that the issue was ripe because of the remedial nature of the Texas Declaratory Judgment Act: "A person with an interest in a written contract may ask a court to determine any question of construction or validity arising under the contract and obtain a declaration of rights, status, or other legal relations thereunder."[296] The record reflected a real controversy because Kellogg had relied on its interpretation of the warranty to support the trial court's take-nothing judgment against

286. *Id.* at 644-45 (quoting Hutson v. Chambless, 300 S.W.2d 943, 945 (Tex. 1957)).
287. *Id.*
288. *Id.*
289. *Id.*
290. *Id.*
291. *Id.* at 653.
292. 201 S.W.3d 272 (Tex. App.—Houston [14th Dist.] 2006, no pet.).
293. *Id.* at 275.
294. *Id.* at 278.
295. *Id.* at 279.
296. *Id.* at 278-79.

Hirschfeld.[297]

Hirschfeld had asked the court to find that the warranty was void because scheduled inspections and maintenance had not occurred. The court of appeals determined that the trial court did not err, because the unambiguous language of the warranty did not condition performance on the scheduled inspections and maintenance.[298]

Hirschfeld then challenged the legal and factual sufficiency of the evidence supporting the jury's finding that Hirschfield failed to substantially perform the warranty contract. Hirschfeld argued that the warranty only required that Hirschfeld "provide" the warranty at the outset, and so the warranty could be suspended, revoked, or repudiated without breaching the warranty itself.[299] The court of appeals initially determined that the trial court's instruction on substantial performance, which tracked the instruction preproposed by Hirschfeld, was not erroneous.[300] The court did not, however, adopt Hirschfeld's construction of the warranty, holding that Hirschfeld failed to conclusively prove that it did not willfully depart from the terms of the subcontract to provide a ten-year warranty; that it did not omit essential points of the subcontract; that it honestly and faithfully performed the construction contract in its material and substantial particulars; and that only a technical or unimportant omission had occurred.[301] Thus, the trial court did not err in dismissing Hirschfeld's declaratory judgment claim with prejudice.[302]

X. STATUTE OF LIMITATIONS AND REPOSE

In *Royce Homes, L.P. v. Dyck*,[303] the central issue was whether untinted windows are inherently undiscoverable such that the statute of limitations is tolled for breach of a construction contract specifying tinted windows. The owners brought their breach of contract and fraud claims more than four years after they closed on and conducted a walk through of the residence. After trial, the jury found for the owners.[304]

On appeal, the Beaumont Court of Appeals determined that untinted windows are not inherently undiscoverable.[305] "An injury is inherently undiscoverable if it is the type of injury that is unlikely to be discovered within the prescribed limitations period, despite due diligence."[306] Although there was some evidence that, in some cases, it is difficult to determine whether a window is tinted, the testimony of Mrs. Dyck showed

297. *Id.* at 278-79.
298. *Id.* at 282.
299. *Id.* at 284.
300. *Id.* at 283.
301. *Id.* at 285.
302. *Id.* at 289.
303. No. 09-06-034-CV, 2006 Tex. App. LEXIS 9484 (Tex. App.—Beaumont Nov. 2, 2006, no pet.).
304. *Id.* at *1-2.
305. *Id.* at *13-14.
306. *Id.* at *8.

that she could tell which windows were tinted and which were not.[307] Thus, the discovery rule did not toll the statute of limitations, which is four years for both breach of contract and fraud.[308]

The Dycks' claim for fraudulent concealment was likewise unavailing because under Texas law, a builder of residential real estate does not have a duty to disclose that which a reasonable investigation would reveal.[309] Specifically, the court of appeals found that the Dycks failed to show that a reasonable investigation would not have disclosed that the windows were untinted.[310] Thus, they failed to prove that Royce was under a duty to disclose the untinted nature of the windows. Based on this holding and the holding that the discovery rule did not operate to toll the Dycks' claims, the court of appeals reversed and rendered judgment for Royce.[311]

XI. RESIDENTIAL CONSTRUCTION LIABILITY ACT

In *Gentry v. Squires Construction, Inc.*,[312] the Dallas Court of Appeals had to determine whether the trial court erred in finding that the Gentrys' DTPA counterclaims were preempted by the Texas Residential Construction Liability Act ("RCLA"). Squires argued that the RCLA did preempt the Gentrys' claims because Squires had made a "reasonable offer" as defined in the RCLA. The court first noted that the RCLA does not create a cause of action because it does not "provide a complete structure for liability" or "contain a description of what conduct will result in liability or an express statement of the elements of a cause of action."[313] The RCLA does modify certain causes of action concerning residential construction defects. The court held that the RCLA does not preempt the DTPA even though the DTPA is mentioned as a cause of action in the RCLA: "It is unreasonable to assume the Texas [l]egislature retained the rights of inspection and settlement under the DTPA, but preempted the liability structure under the DTPA that gives rise to those rights."[314] Instead, the court held that the RCLA "clearly authorizes suits for breach of contract or breach of warranty after" certain pre-suit requirements are met.[315] Accordingly, the court of appeals held that the trial court erred in dismissing the Gentrys' DTPA claims.[316] The judgment was reversed and remanded for trial on those claims.[317]

307. *Id.* at *12-13.
308. *Id.* at *14.
309. *Id.* at *17-18.
310. *Id.* at *18.
311. *Id.*
312. 188 S.W.3d 396 (Tex. App.—Dallas 2006, no pet.).
313. *Id.* at 404.
314. *Id.* at 405.
315. *Id.*
316. *Id.* at 406.
317. *Id.*