
January 2006

Construction and Surety Law

Toni Scott Reed

Michael D. Feiler

Recommended Citation

Toni Scott Reed & Michael D. Feiler, *Construction and Surety Law*, 59 SMU L. REV. 1079 (2006)
<https://scholar.smu.edu/smulr/vol59/iss3/9>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

CONSTRUCTION AND SURETY LAW

*Toni Scott Reed**
*Michael D. Feiler***

TABLE OF CONTENTS

I. INTRODUCTION	1081
II. SOVEREIGN IMMUNITY	1081
A. THE SUPREME COURT AND WAIVER THROUGH FILING SUIT	1082
B. COURT OF APPEALS' DECISIONS ON WAIVER BY FILING SUIT	1084
C. WAIVER THROUGH "SUE AND BE SUED" LANGUAGE IN GOVERNMENT CODE AND CITY CHARTER	1089
D. WAIVER THROUGH "SUE AND BE SUED" LANGUAGE IN EDUCATION CODE	1092
E. WAIVER THROUGH "SUE AND BE SUED" LANGUAGE IN TRANSPORTATION CODE	1094
F. NO WAIVER THROUGH "SUE AND BE SUED" LANGUAGE	1095
G. NO WAIVER UNDER TORT CLAIMS ACT FOR GOVERNMENTAL FUNCTION	1096
H. IMMUNITY FOR CONTRACTORS HIRED BY GOVERNMENTAL ENTITIES	1098
I. WAIVER AND ADMINISTRATIVE PROCESS	1099
III. PASS-THROUGH CLAIMS	1100
A. THE TEXAS SUPREME COURT'S RULE ON PASS- THROUGH CLAIMS	1100
B. FEDERAL AND STATE COURTS' DECISIONS ON PASS- THROUGH CLAIMS	1102
IV. CLAIMS ON PERFORMANCE BONDS AND PAYMENT BONDS	1103

* Toni Scott Reed received her undergraduate degrees (B.A. 1990 *summa cum laude*, B.B.A. 1990 *summa cum laude*) and her law degree (J.D. 1993 *cum laude*) from Southern Methodist University. She is a partner in the Dallas office of Strasburger & Price, L.L.P. She specializes in business and commercial litigation, with a particular focus on construction and surety matters. She is a member of the American Bar Association's Forum on the Construction Industry and Fidelity and Surety Law Committee, as well as the Construction Sections of the State Bar of Texas and the Dallas Bar Association.

** Michael D. Feiler is a 2006 graduate of Southern Methodist University Dedman School of Law. He received his undergraduate degree (B.A. 1996, philosophy) from the University of Colorado at Boulder and his graduate degree (M.A. 2003, philosophy) from Boston College. He will join Strasburger & Price, L.L.P. after graduation.

A.	SURETY BUSINESS IS NOT INSURANCE AND ARTICLE 21.21 DOES NOT APPLY	1104
B.	PROPER NOTICES ON A PAYMENT BOND	1104
C.	SCOPE OF A BOND CLAIM	1105
D.	COMPLIANCE WITH PROPERTY CODE	1106
E.	RETAINAGE IS PROPERTY OF SURETY, NOT BANKRUPTCY ESTATE	1107
F.	RECOVERY ON INDEMNITY AGREEMENT	1108
V.	ARBITRATION CLAUSES AND RIGHTS	1108
A.	NONSIGNATORIES CAN BE BOUND BY ARBITRATION PROVISIONS	1109
B.	CONDITIONS PRECEDENT MUST BE SATISFIED	1111
C.	UNCONSCIONABILITY	1112
D.	NOTICE PROVISIONS DO NOT CREATE BINDING AGREEMENT	1113
E.	GOVERNMENT ENTITIES AND ARBITRATION	1113
F.	CHALLENGES TO ARBITRATION AWARDS	1114
VI.	MECHANIC'S & MATERIALMAN'S LIENS	1115
A.	CONTRACT WITH ACTUAL OWNER REQUIRED	1115
B.	NOTICE REQUIREMENTS	1117
C.	HOMESTEAD EXEMPTION	1119
D.	PLACEMENT AGENCY ENTITLED TO LIEN	1121
E.	FRAUDULENT LIENS	1122
F.	ASSIGNMENT OF LIEN	1123
G.	STATUTE OF LIMITATIONS ON LIEN RIGHTS	1124
VII.	CONSTRUCTION DISPUTES	1124
A.	CONTRACT AND TORT CLAIMS	1125
B.	SUBSTANTIAL PERFORMANCE AND GOVERNING AGREEMENT	1126
C.	CONDITIONAL PAYMENT CLAUSES	1127
VIII.	BREACH & WAIVER OF WARRANTY	1128
IX.	CONSTRUCTION DEFECTS AND INSURANCE COVERAGE	1129
A.	"OCCURRENCE"	1129
B.	NO DUTY TO DEFEND OR INDEMNIFY FOR EXCLUDED CONSTRUCTION DEFECTS	1130
C.	COVERAGE—PROPERTY DAMAGES	1131
X.	STATUTE OF LIMITATIONS AND REPOSE	1133
XI.	CONTRACTOR LIABILITY FOR SUBCONTRACTOR'S EMPLOYEES	1135
XII.	RESIDENTIAL CONSTRUCTION LIABILITY ACT ...	1137
XIII.	THE SUBSTANTIAL PERFORMANCE DOCTRINE ...	1138
A.	FINAL PAYMENT	1138
B.	SUBSTANTIAL PERFORMANCE, MATERIAL BREACH, AND EXCUSED PERFORMANCE	1138
XIV.	LEGISLATIVE DEVELOPMENTS	1140
A.	THE PROPERTY CODE	1140

B. SOVEREIGN IMMUNITY IN CONSTRUCTION
 CONTRACTS 1140

I. INTRODUCTION

DURING 2004 and 2005, the developments in construction and surety law focused on a wide variety of substantive issues, most notably decisions regarding sovereign immunity. The Texas Supreme Court and many courts of appeals issued decisions regarding a city or other governmental entity’s immunity from suit in a construction dispute.

Various state and federal courts of appeals also issued decisions regarding pass-through claims, the enforceability of arbitration clauses, payment and performance bond disputes, general construction disputes, mechanic’s liens, waiver of implied warranties, and insurance coverage in construction disputes. These courts issued a large number of decisions that directly impact the construction and surety practitioner. A number of those decisions are discussed here. Very notably, the various Texas courts of appeal have continued to discuss and apply the rulings of many Texas Supreme Court decisions discussed in the last several years’ survey articles.

II. SOVEREIGN IMMUNITY

The issue of sovereign immunity and the waiver of immunity from suit were among the most common subjects for decisions rendered by the Texas courts in the construction context during 2004 and 2005. Both the Texas Supreme Court and the various courts of appeal continued to apply the general rule regarding the “no waiver by conduct” concept, but more significantly, they turned their attention to immunity from suit exceptions, including waiver as a result of a governmental entity filing a claim or counterclaim and waiver by the language in Texas statutes and city charters.

Decisions addressing immunity from suit continue to build upon the law of sovereign immunity established by the Texas Supreme Court over the last several years. The 2001 and 2002 supreme court decisions set the stage for this continuing analysis of immunity in the context of construction disputes. The 2001 opinion in *General Services Commission v. Little-Tex Insulation Co.*¹ focused on the issue of waiver by conduct, specifically considering contractor arguments that the state waived immunity by merely accepting the contract’s benefits. In that case, the court concluded that under the new scheme set forth in Government Code Chapter 2260, “a party simply cannot sue the State for breach of contract absent legislative consent under Chapter 107.² Compliance with Chapter 2260,

1. 39 S.W.3d 591 (Tex. 2001).
 2. See TEX. GOV’T CODE ANN. §§ 2260.001-.108 (Vernon 2001).

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 was whether IT-Davy, a general contractor, could sue the Texas Natural Resource Conservation Commission ("TNRCC"), a state agency, for breach of contract. 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, Justice Hecht's concurring opinion, which disagrees with the court's broad language, contains perhaps the most significant analysis and an indication of future decisions on the issue of sovereign immunity. Justice Hecht doubts "whether governmental immunity from suit for breach of contract can be applied so rigidly," but declines to decide any broader issues not presented by the facts of the case:

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 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*.⁷

Since these two supreme court cases, contractors and public entities have focused on arguments regarding the impact of a public entity filing immunity-from-suit claims or counterclaims. During the Survey period, the supreme court weighed in on the very important issue of waiver through filing suit.

A. THE SUPREME COURT AND WAIVER THROUGH FILING SUIT

In 2004, the Texas Supreme Court affirmed earlier case law regarding sovereign-immunity-doctrine waiver when a public entity files claims or counterclaims, thereby invoking the jurisdiction of the courts. In *Reata*

3. *Id.*

4. 74 S.W.3d 849 (Tex. 2002).

5. *Id.* at 857.

6. *Id.* at 860.

7. *Id.* at 860-61 (J. Hecht, C.J. Phillips, J. Owen, J. Jefferson, concurring) (internal citations omitted); see *Fed. Sign v. Tex. S. Univ.*, 951 S.W.2d 401, 408 n.1 (Tex. 1997).

Construction Corp. v. City of Dallas,⁸ the Texas Supreme Court concluded that a city waives its governmental immunity from suit by asserting claims for affirmative relief in a lawsuit to which it is named as a party.⁹ *Reata* arose out of a construction accident causing property damage. The City of Dallas issued Dynamic Cable Construction a license to install fiber-optic cable in a downtown area. Dynamic subcontracted with Reata to drill a conduit. Reata inadvertently drilled into a water main, flooding a residential building. The building owner sued Dynamic and Reata, and Reata then filed a third-party claim against the city for alleged negligence in misidentifying the water main's location.¹⁰

The city filed special exceptions to the Reata claims, asserting that the claims were not within the Texas Tort Claims Act's waiver of immunity. The city also "intervened" to file claims against Dynamic, and later amended its plea in intervention to assert claims for damages against Reata as well. The city then filed a plea to the jurisdiction, asserting governmental immunity from suit with respect to Reata's claims. Reata responded to the plea, contending that governmental immunity did not apply because the city had subjected itself to jurisdiction by intervening in the lawsuit and seeking affirmative relief.¹¹

The trial court denied the city's plea to the jurisdiction, but the court of appeals reversed, holding that the city's intervention did not waive its right to assert subject-matter jurisdiction.¹² On appeal, the Texas Supreme Court reversed the appellate court's holding:

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.¹³

The supreme court's holding in *Reata* is completely consistent with Justice Hecht's opinion in *IT-Davy* and with established authority recognizing that when the state invokes the court's jurisdiction 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."¹⁴

The Texas Supreme Court properly referred to and followed earlier decisions in reaching this conclusion, including *Anderson, Clayton & Co.*

8. 47 Tex. Sup. Ct. J. 408 (Tex. 2004) (per curiam).

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.* at 409.

13. *Id.*

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

*v. State*¹⁵ and *State v. Martin*.¹⁶ In its discussion, the supreme court found no reason to draw a distinction between a governmental entity as plaintiff and a governmental entity that intervenes to seek affirmative relief.¹⁷ In either case, a governmental entity would subject itself to the jurisdiction of the court and waive immunity.¹⁸

The Texas Supreme Court granted rehearing on the *Reata* case. Although oral arguments have been completed, the supreme court has yet to issue a subsequent opinion.

B. COURT OF APPEALS' DECISIONS ON WAIVER BY FILING SUIT

Both before and after *Reata*, various courts of appeal considered waiver of immunity from suit through seeking affirmative relief. The Texas courts of appeal consistently have held that, by filing claims for affirmative relief, a public entity waives its claim of immunity from suit.

For example, before *Reata*, the Austin Court of Appeals, in *State of Texas v. Fidelity and Deposit Co. of Maryland*¹⁹ held that the State of Texas waives sovereign immunity when, as a plaintiff, it files a case in district court and the defendant files a compulsory counterclaim.²⁰ In *Fidelity*, the Texas Department of Transportation ("TxDOT") terminated the original contractor on a TxDOT project. The surety, Fidelity and Deposit Co., completed the project after TxDOT demanded it to do so under the performance bond. Upon completion, TxDOT sued Fidelity, seeking to recover additional project costs that TxDOT claimed it had incurred. Fidelity counterclaimed for breach of the same contract.²¹

The trial court denied the State's plea to the jurisdiction, finding that the State had waived sovereign immunity from suit by filing the case in district court.²² The trial court held that the State subjected itself to the counterclaims that were related to or germane to its original claims.²³ In analyzing the issue, the court of appeals noted that a well-accepted exception to the sovereign immunity doctrine is waiver by filing a suit in district court in which the state is the plaintiff.²⁴ The court's language on this issue was clear and forceful:

We acknowledge and reaffirm that it is the legislature's sole province to waive or abrogate sovereign immunity. But just as Texas courts have adhered to this general rule for over a century, they have also recognized an exception to this rule—when the State initiates suit. It is well established that the State's initiation of suit is an exception to

15. *Anderson*, 62 S.W.2d at 107.

16. *Martin*, 347 S.W.2d at 809.

17. *Reata*, 47 Tex. Sup. Ct. J. at 409.

18. *Id.* at 409-10.

19. 127 S.W.3d 339 (Tex. App.—Austin 2004, pet. filed).

20. *Id.* at 347.

21. *Id.* at 341-42.

22. *Id.* at 341.

23. *Id.*

24. *Id.* at 343.

sovereign immunity from suit clearly recognized by Texas courts.²⁵

The *Fidelity* court also relied on Justice Hecht's concurring opinion in *IT-Davy* in reaching its holding.²⁶ Further, the court rejected the State's argument that it sued Fidelity as a surety, and Fidelity counterclaimed as a completing contractor.²⁷ The court said that argument was unpersuasive and that the claims and counterclaims were related to the parties' additional expenses and costs incurred in connection with the project.²⁸

Finally, the Austin court held that the administrative process on Fidelity, under Transportation Code section 201.112, was not a proper procedure because the statute limited its application to highway projects.²⁹ Because this was a building, not a highway project, section 201.112 did not apply.³⁰ As a result, the court concluded that Fidelity had no administrative remedy to exhaust.³¹

After *Reata*, the Houston Court of Appeals in *Ray Ferguson Interests, Inc. v. Harris County Sports & Convention Corp.*³² agreed that a counterclaim filing waived the city's immunity from suit.³³ The Harris County Sports & Convention Corporation ("HCSCC") contracted with Ferguson in 1999 to build parking lots and facilities at Reliant Stadium. After substantial completion of the project, problems occurred with some of the structures. Ferguson alleged that HCSCC, its engineers, and its other contractors were at fault for the problems. HCSCC demanded warranty work and withheld \$300,000 in retainage from Ferguson. Ferguson alleged that it expended over \$400,000 in performing remedial work while trying to negotiate a change order. Ferguson ceased work when the parties could not reach any resolution. Ferguson sued HCSCC and others, claiming breach of warranty, breach of contract, and negligence for failure to provide accurate and suitable plans and specifications. HCSCC filed an answer and counterclaim for damages and then filed a plea to the jurisdiction, which the trial court granted.³⁴

Ferguson argued that HCSCC waived immunity from suit by asserting the counterclaim for affirmative relief that arose out of and related to Ferguson's claims. HCSCC argued its counterclaim did not waive immunity because it was compulsory, not permissive. The court of appeals found the facts analogous to the *Reata* case and applied its holding.³⁵

The court found that HCSCC's counterclaim did seek affirmative relief, and it noted that:

25. *Id.*

26. *Id.* at 344.

27. *Id.* at 345.

28. *Id.*

29. *Id.* at 346.

30. *Id.* at 346-47; see TEX. TRANSP. CODE ANN. § 221.001 (West 1999).

31. *Fidelity & Deposit Co.*, 127 S.W.3d at 346-47.

32. 169 S.W.3d 18 (Tex. App.—Houston [1st Dist.] 2004, no pet. h.).

33. *Id.* at 21.

34. *Id.* at 21-22.

35. *Id.* at 26.

[t]o qualify as a claim for affirmative relief, a defensive pleading must allege that the defendant has a cause of action, independent of the plaintiff's claim, on which he could recover benefits, compensation or relief, even though the plaintiff may abandon his cause of action or fail to establish it.³⁶

Further, the Houston court concluded that the counterclaim was "incident to, connected with, [arose] out of, or [was] germane to" the matter in controversy between HCSCC and Ferguson and to Ferguson's claims.³⁷ Ferguson alleged that HCSCC breached the contract by failing to issue change orders, direct work, pay retainage, and provide proper plans, among other things. HCSCC's counterclaim arose from the same contract and Ferguson's alleged failure to perform.³⁸

An earlier Dallas Court of Appeals opinion helped the court in determining that the term "germane" is not narrower in scope than the test for a compulsory counterclaim.³⁹ It read the phrase "incident to, connected with, arises out of, or is germane to" as including claims that "arise from the same transaction" and that depend on facts pertinent to the parties' conduct regarding the same transaction.⁴⁰

Finally, the court determined that it was irrelevant that HCSCC filed a counterclaim instead of intervening by filing a pleading like in *Reata*.⁴¹ The court concluded that, like an intervener, a party that asserts a counterclaim for affirmative relief is asserting the type of claim that could be brought in its own name if it filed its own suit.⁴² Accordingly, the court concluded that the counterclaim did waive the city's immunity from suit.⁴³

The court also rejected HCSCC's argument that the counterclaim was compulsory.⁴⁴ It noted that if a governmental entity truly enjoys immunity from a plaintiff's claims, then its failure to assert a compulsory counterclaim for affirmative relief cannot have a preclusive effect that might occur in other contexts.⁴⁵ Thus, when a court considers a plea to the jurisdiction based on a claim of immunity from suit, the court must consider that it has no subject-matter jurisdiction and dismiss the case, if that assertion is correct.⁴⁶ Under those circumstances, the governmental-entity defendant need not assert any counterclaim because there is no plaintiff's

36. *Id.* at 25 (quoting *Gen. Land Office v. OXY U.S.A., Inc.* 789 S.W.2d 569, 570 (Tex. 1990)).

37. *Id.* at 25 (citing *Reata Constr. Corp. v. City of Dallas*, 47 Tex. Sup. Ct. J. 408 (2004)).

38. *Id.* at 24.

39. *Id.* (citing *City of Dallas v. Redbird Dev. Corp.*, 143 S.W.3d 375 (Tex. App.—Dallas 2004, no pet. h.)).

40. *Id.*

41. *Id.* at 25.

42. *Id.*

43. *Id.*

44. *Id.* at 26.

45. *Id.*

46. *Id.*

claim over which the court must exercise jurisdiction.⁴⁷ On the other hand, if the court determines that there is no immunity from suit for a plaintiff's claim and denies a plea to the jurisdiction, the governmental entity must then assert its compulsory counterclaims.⁴⁸ Accordingly, the Houston court concluded that the defendant entity should file and seek a ruling on its jurisdictional plea before filing any claims for affirmative relief.⁴⁹

After *Reata*, the Dallas Court of Appeals rendered its decision in *City of Grand Prairie v. Irwin Seating Co.*⁵⁰ In that case, the Linbeck/Con-Real/Russell Joint Venture contracted with Texas NextStage to construct a theater in Grand Prairie. During construction of the project, Texas NextStage sold the property and improvements to the City of Grand Prairie. When the contractor did not receive payment for the construction, it first filed a mechanic's lien against the property and then filed a suit to foreclose its lien, naming the City of Grand Prairie as a party as the current owner of the property subject to the lien. Under the Property Code and Texas Constitution, the lien rights related back to and incepted as of the beginning of work on the project, well before the City of Grand Prairie acquired it. Grand Prairie responded by filing an answer and then obtaining a bond from RLI Insurance to indemnify the property against the lien. The city then filed a counterclaim against the contractor for damages, a declaratory judgment that the lien was invalid, and a third-party petition for damages against new parties to the lawsuit. After filing the counterclaim and third-party claims, Grand Prairie filed a plea to the jurisdiction, arguing immunity from suit.⁵¹

The Dallas Court of Appeals noted that immunity from suit bars a lawsuit against a city unless the city expressly gives consent to the suit, which may be given by statute, by legislative resolution, or by waiver through filing suit.⁵² The City of Grand Prairie argued that it did not initiate any legal proceedings that would result in a waiver of immunity from suit because its counterclaim and third-party claims sought damages in any amounts the city was found to owe the plaintiff. The Dallas court rejected the argument, citing *Reata*. “[B]y filing a suit for damages, a governmental entity waives immunity from suit for any claim that is incident to, connected with, arises out of, or is germane to the suit of controversy brought by the State.”⁵³

In its discussion, the court noted that it had previously held that a governmental entity's counterclaim seeking affirmative relief constitutes “an

47. *Id.*

48. *Id.*

49. *Id.*

50. 170 S.W.3d 216, 220 (Tex. App.—Dallas 2005, pet. filed).

51. *Id.* at 217-18.

52. *Id.* at 218-19 (citing *Reata Constr. Corp. v. City of Dallas*, 47 Tex. Sup. Ct. J. 408 (Tex. 2004) (per curiam)).

53. *Id.* at 219 (citing *Reata*, 47 Tex. Sup. Ct. J. at 408).

intentional relinquishment of any claim to governmental immunity.”⁵⁴ It also reiterated the choice a public entity faces when sued: invoke the jurisdiction of the court by seeking affirmative relief or challenge the court’s subject-matter jurisdiction over the dispute.⁵⁵ Upon review of the facts, the Dallas court concluded that the City of Grand Prairie invoked the jurisdiction of the trial court by seeking affirmative relief in its counterclaims and third-party claims.⁵⁶ The court also concluded that the other parties’ claims were incident to, connected with, arose out of, or were germane to Grand Prairie’s counterclaim.⁵⁷ Finally, the court noted that the city’s counterclaim even stated that “jurisdiction and venue have already been established in this Court, and [Grand Prairie’s] claim [sic] arise out of and are related to the claims at issue in this suit.”⁵⁸

Earlier, the Dallas Court of Appeals reached a similar decision in *City of Irving v. Inform Construction, Inc.*⁵⁹ In this case, Inform Construction contracted with the city to construct a recreation center and related site work. Inform sued the city in 2002, alleging that it failed to meet its contractual payment obligations. The city counterclaimed for damages for Inform’s alleged breach of the contract.⁶⁰

The city later filed a plea to the jurisdiction. The city argued that it did not pursue its earlier request for affirmative relief when it filed a plea to the jurisdiction, but the Dallas court noted that it did not amend its answer or withdraw the counterclaim.⁶¹ The city also objected to Inform’s argument on appeal, for the first time, that the city’s counterclaim was a waiver of immunity under the later-decided *Reata* decision. The Dallas Court of Appeals held that Inform was merely noting an additional reason why the trial judge correctly decided that the court had subject-matter jurisdiction, and that the court of appeals makes a de novo review of the trial court’s ruling when the issue is one of law.⁶² The Dallas court further noted that it is required to follow the state supreme court’s expression of the law.⁶³

In reviewing the facts of Inform’s case, the Dallas court noted that the city’s counterclaim requested affirmative relief in the form of breach-of-contract damages.⁶⁴ The Dallas court concluded that there was no distinction between an affirmative claim for relief filed by a third-party de-

54. *Id.* (citing *City of Dallas v. Martin*, 140 S.W.3d 924, 925 (Tex. App.—Dallas 2004, no pet. h.); *City of Dallas v. Bargman*, No. 05-04-00316-CV, 2004 Tex. App. LEXIS 8858, at *3 (Tex. App.—Dallas Oct. 5, 2004, no pet. h.); *City of Irving v. Inform Constr., Inc.*, 143 S.W.3d 371, 373 (Tex. App.—Dallas 2004, pet. filed)).

55. *Id.*

56. *Id.*

57. *Id.* at 220.

58. *Id.*

59. 143 S.W.3d 371, 373 (Tex. App.—Dallas 2004, pet. filed).

60. *Id.* at 372-73.

61. *Id.* at 371.

62. *Id.* at 373-74.

63. *Id.* at 373.

64. *Id.* at 374.

fendant (as in *Reata*) and a defendant, as in the present case.⁶⁵ Thus, the Dallas court concluded that the City of Irving waived its claim of immunity by filing a counterclaim for damages.⁶⁶

The Beaumont Court of Appeals followed *Reata* in *Port Neches-Groves Independent School District v. Pyramid Constructors, L.L.P.*⁶⁷ In that case, Pyramid Constructors sued the school district for breach of contract. The district then filed a counterclaim for breach of contract. The parties settled various claims between themselves, but they agreed that Pyramid would retain all causes of action for retainage withheld under the contract. Pyramid dismissed its claims with prejudice, except for those relating to retainage. At that point, the school district filed a plea to the jurisdiction, arguing that the trial court lacked subject-matter jurisdiction to hear the case based on immunity from suit.⁶⁸

The Beaumont Court of Appeals concluded that the school district waived immunity from suit by filing its counterclaim.⁶⁹ It noted that the district could have asserted immunity without filing a counterclaim to seek affirmative relief.⁷⁰ Because it filed the counterclaim, however, the district waived immunity from suit.⁷¹

These courts of appeals' decisions illustrate uniformity in following *Reata* among courts addressing waiver by filing suit.

C. WAIVER THROUGH "SUE AND BE SUED" LANGUAGE IN GOVERNMENT CODE AND CITY CHARTER

In addition to finding waiver by filing claims, many Texas courts of appeal continued to find waiver as a result of the "sue and be sued" and "plead and be impleaded" language included in the Texas Local Government Code and the various city charters.

For example, in *Utility Contractors of America, Inc. v. City of Canyon*,⁷² the Amarillo Court of Appeals concluded that the "sue and be sued" language in the Local Government Code and the Canyon City Charter waived immunity from suit.⁷³ In that case, the City of Canyon contracted with Utility Contractors of America, Inc. for the design of a municipal-water and sewer-lines extension. Utility completed the project late but claimed that deficiencies in the information provided caused the delay. Utility then sought payment for additional work required for completion. The city denied the claims. Utility filed suit against the city for breach of contract and negligence. The city asserted governmental immunity, but

65. *Id.* at 375.

66. *Id.*

67. 140 S.W.3d 440, 444 (Tex. App.—Beaumont 2004, pet. filed).

68. *Id.* at 441-42.

69. *Id.* at 443.

70. *Id.*

71. *Id.*

72. No. 07-03-0075-CV, 2005 Tex. App. LEXIS 4038, at *7 (Tex. App.—Amarillo May 24, 2005, no pet. h.) (mem op.).

73. *Id.* at *7-8.

also filed a counterclaim against Utility for breach of contract. The trial court granted the plea in abatement as to the plaintiff's tort claims and later granted a plea to the jurisdiction for the contract claims.⁷⁴

Utility later filed a motion for new trial, arguing that the city waived immunity by accepting benefits under the contract. The city filed a non-suit of its counterclaim against the plaintiff. The trial court overruled the motion for new trial.⁷⁵

On appeal, Utility argued that section 51.075 of the Local Government Code waived the city's immunity from suit by providing that a municipality "may plead and be impleaded in any court," and that the city charter waived immunity by stating that the city "may sue and be sued, may contract and be contracted with; [and] may implead and be impleaded in all courts having jurisdiction of the subject matter involved."⁷⁶ The court, relying on a 2004 decision, again concluded that the language in the Local Government Code and city charter clearly and unambiguously waived the city's immunity from suit.⁷⁷ The court also noted that the city's filing of a counterclaim constituted a waiver of immunity from suit.⁷⁸

Similarly, the Houston Court of Appeals for the First District agreed that the language in the Local Government Code and the applicable city charter waived immunity from suit. In *United Water Services, Inc. v. City of Houston*,⁷⁹ United Water Services contracted with the City of Houston to operate and maintain a water-purification plant. The city refused to pay United for services under the contract, arguing that United breached its obligations. The city also submitted a claim on the performance bond to Continental Insurance Company, asserting that United's breach caused damage to the city.⁸⁰

United filed suit against the city, seeking damages for breach of contract and a declaratory judgment that it did not breach the agreement. The City of Houston filed a counterclaim against United and a separate suit against the insurer in federal court. The city then filed a plea to the jurisdiction, asserting that it was immune from suit in the state court. United argued that Local Government Code section 51.075 waived immunity from suit. United also argued that the city waived immunity from suit by filing its counterclaim and federal-court action.⁸¹

With regard to the charter's "sue and be sued" language, the court concluded that the Texas Supreme Court determined in *Missouri Pacific Railroad Co. v. Brownsville Navigation District*⁸² that such language waived

74. *Id.* at *1-4.

75. *Id.* at *4.

76. *Id.* at *7 (citing TEX. LOC. GOV'T CODE § 51.075 (Vernon 1999) and CANYON CITY CHARTER art. III, § 3.01(a)).

77. *Id.* at *7 (citing *City of Lubbock v. Adams*, 149 S.W.3d 820 (Tex. App.—Amarillo 2004, pet. filed)).

78. *Id.* at *9.

79. 137 S.W.3d 747, 758 (Tex. App.—Houston [1st Dist.] 2004, pet. filed).

80. *Id.* at 749.

81. *Id.*

82. 453 S.W.2d 812 (Tex. 1970).

immunity from suit and that it was bound by that precedent.⁸³ The court also analyzed the city charter at some length, concluding that the “sue and be sued” language in it was a clear and unambiguous waiver of the city’s immunity from suit.⁸⁴ It acknowledged the existence of contrary decisions in other courts, but refused to follow them.⁸⁵

The Houston Court of Appeals for the Fourteenth District reached a similar conclusion in *City of Houston v. Clear Channel Outdoor, Inc.*⁸⁶ That court concluded that it would not draw a distinction between the “sue and be sued” language and the “plead and be impleaded” language, and that both clearly and unambiguously waived a city’s immunity from suit.⁸⁷

The Eastland Court of Appeals found that Government Code section 392.065 waived a housing authority’s sovereign immunity from suit in *Gene Duke Builders, Inc. v. Abilene Housing Authority*.⁸⁸ The contractor and housing authority in that case entered into a construction contract to repair housing units. The parties disputed issues relating to completion and payment with one another.⁸⁹ Relying on the reasoning in *Missouri Pacific*, the court of appeals determined that section 392.065, which allows a housing authority to “sue and be sued,” waived the housing authority’s sovereign immunity from suit.⁹⁰

In addition, the court concluded that the administrative provisions in section 2260 of the Texas Government Code would not apply to the dispute because there was no authority to establish that the housing authority was a “unit of state government.”⁹¹ The court held that nothing in section 2260 defined the housing authority as a unit of state government, and the authority did not fall within the statute’s catch-all categories.⁹²

Finally, the Corpus Christi Court of Appeals concluded that the language of the Government Code and city charter waived the City of Alton’s sovereign immunity from suit in *City of Alton v. Sharyland Water Supply Corp.*⁹³ In that case, the court determined that immunity from suit did not bar breach-of-contract claims asserted against the city for the same reasons cited by the various courts of appeal discussed above.⁹⁴

83. *United Water Servs.*, 137 S.W.3d at 751.

84. *Id.* at 757.

85. *Id.* at 758 n.14.

86. 161 S.W.3d 3, 18 (Tex. App.—Houston [14th Dist.] 2004, pet. granted).

87. *Id.* at 8.

88. 168 S.W.3d 215, 223 (Tex. App.—Eastland 2005, pet. filed).

89. *Id.* at 217.

90. *Id.* at 218.

91. *Id.* at 219.

92. *Id.*

93. 145 S.W.3d 673, 682-83 (Tex. App.—Corpus Christi 2004, pet. denied).

94. *Id.*

D. WAIVER THROUGH "SUE AND BE SUED" LANGUAGE
IN EDUCATION CODE

The Texas courts of appeal looked at statutes in addition to the Texas Local Government Code in analyzing the "sue and be sued" language during 2004 and 2005. Three cases analyzed the Texas Education Code and determined that waiver of immunity from suit occurred as a result of the "sue and be sued" language in that statute.

In *Alamo Community College District v. Browning Construction Co.*,⁹⁵ the San Antonio Court of Appeals held that a junior college district waived immunity from suit through a state charter.⁹⁶ Browning Construction and the Alamo district contracted for the construction of a new Alamo campus. Browning sued Alamo for breach of contract. Alamo filed a plea to the jurisdiction, arguing sovereign immunity from suit.⁹⁷

The court quickly disposed of Alamo's argument, noting that it has specifically held that junior-college community districts are not immune from suit:

ACCD is a junior college community district organized pursuant to chapter 130 of the Texas Education Code. Under chapter 130, ACCD's board of trustees' "powers and duties" "in the . . . management and control of the junior college" are governed by "the general law governing the . . . management and control of independent school districts insofar as the general law is applicable." Part of the "general law" governing the management and control of independent school districts is the Texas Legislature's consent to suits against "[t]he trustees of an independent school district . . . in the name of the district"

. . . By subjecting junior college districts like ACCD to the same general law applicable to independent school districts, it appears to us, clearly and unambiguously, the Texas Legislature granted its consent to sue junior college community districts and we so hold.⁹⁸

The court further noted that the basis of its conclusion in an earlier case, as well as in the *Browning* case, was the Texas Supreme Court's holding in *Missouri Pacific Railroad Co. v. Brownsville Navigation District*.⁹⁹ In that case, the supreme court concluded that the language of a 1925 statute clearly and unambiguously waived the Navigation District's immunity from suit in stating that "[a]ll navigation districts established under this Act may . . . sue and be sued in all courts of this State in the name of such navigation district."¹⁰⁰

The court noted that the Education Code similarly provided that the

95. 131 S.W.3d 146 (Tex. App.—San Antonio 2004, pet. dismissed).

96. *Id.* at 155.

97. *Id.* at 150-51.

98. *Id.* at 151-52 (quoting *Alamo Cmty. Coll. Dist. v. Obayashi Corp.*, 980 S.W.2d 745, 747-48 (Tex. App.—San Antonio 1998, pet. denied)).

99. 453 S.W.2d 812 (Tex. 1970).

100. *Id.* at 813.

trustees of an independent school district may sue and be sued.¹⁰¹ Based on that language, which the court found unambiguous, the court concluded that the district had waived any immunity from suit.¹⁰²

The court of appeals rejected the district's argument that the *IT-Davy* case suggested there was immunity from suit.¹⁰³ The court distinguished the holding in that case, which focused on waiver by accepting benefits under a contract.¹⁰⁴ The court also noted a Dallas Court of Appeals' decision that found no waiver of immunity for school districts because of the Education Code's language, but it declined to follow that case, noting its inconsistency with the Texas Supreme Court's decision in *Missouri Pacific*.¹⁰⁵

In *Longview Independent School District v. Vibra-Whirl, Ltd.*¹⁰⁶ the Texarkana Court of Appeals also concluded that the Education Code waives immunity from suit for a Texas school district.¹⁰⁷ In that case, Vibra-Whirl contracted with the school district to install a synthetic-turf football field. The school district refused to pay Vibra-Whirl after a contract dispute. Vibra-Whirl filed suit, and the district asserted a plea to the jurisdiction based on sovereign immunity. The trial court denied the plea.¹⁰⁸

On appeal, Vibra-Whirl argued that Texas Education Code section 11.151 waived the district's immunity from suit in its "sue and be sued" language. The court noted the Texas Supreme Court's decision in *Missouri Pacific*, which found a waiver, as well as cases finding no waiver.¹⁰⁹ After analyzing these authorities, the court determined that it was bound to follow the Texas Supreme Court's precedent and concluded that the "sue and be sued" language did effect a waiver of immunity from suit.¹¹⁰

Finally, in *Lamesa Independent School District v. Booe*,¹¹¹ the Eastland Court of Appeals concluded that the Texas Education Code waived a school district's immunity from suit.¹¹² Booe Roofing Company contracted with the school district to provide roof installation and repair services. Booe alleged that the school district refused to pay for work performed and filed suit, asserting an implied contract or a right to recover under *quantum meruit*. The school district filed a plea to the jurisdiction, arguing immunity from suit. The trial court denied the plea,

101. *Browning*, 131 S.W.3d at 152 (citing TEX. EDUC. CODE ANN. § 11.151(a) (Vernon 1996)).

102. *Id.* at 154.

103. *Id.* at 152-53.

104. *Id.* at 153.

105. *Id.* at 154 (declining to follow *Satterfield & Pontikes Constr., Inc. v. Irving Indep. Sch. Dist.*, 123 S.W.3d 63 (Tex. App.—Dallas 2003, pet. granted)).

106. 169 S.W.3d 511 (Tex. App.—Texarkana 2005, no pet. h.).

107. *Id.* at 514.

108. *Id.* at 513.

109. *Id.* at 514.

110. *Id.*

111. No. 11-03-00394-CV, 2005 Tex. App. LEXIS 7137 (Tex. App.—Eastland Aug. 31, 2005, pet. filed).

112. *Id.* at *1.

finding that the Texas Education Code waived sovereign immunity and that the school district waived immunity through its conduct during the work and litigation.¹¹³ The court of appeals affirmed on the first ground.¹¹⁴

The Eastland court held that the “sue and be sued” language in the Education Code plainly gives general consent for a governmental entity to be sued, citing the *Missouri Pacific* holding.¹¹⁵ The court also noted that legislation passed in 2005 expressly waives immunity from suit for local governmental entities, including school districts, that enter into goods and services contracts.¹¹⁶ Accordingly, the court concluded that the district clearly and unambiguously waived immunity from suit.¹¹⁷

E. WAIVER THROUGH “SUE AND BE SUED” LANGUAGE IN TRANSPORTATION CODE

In *Metropolitan Transit Authority v. MEB Engineering, Inc.*,¹¹⁸ the Houston Court of Appeals for the First District concluded that the “sue and be sued” language of the Texas Transportation Code waived a transit authority’s immunity from suit.¹¹⁹ Metropolitan Transit Authority (“Metro”) entered into three construction contracts with MEB Engineering. MEB alleged that it performed extra work for Metro and suffered delays as a result of Metro’s failure to plan. MEB sued Metro for breach of contract, *quantum meruit*, and fraud. Metro filed a counterclaim, alleging that it was entitled to liquidated damages from MEB. It then filed a plea to the jurisdiction, asserting that it was immune from suit as a governmental unit. MEB responded that the “sue and be sued” language of Texas Transportation Code section 451.054 waived immunity from suit. The trial court denied Metro’s plea to the jurisdiction on the breach-of-contract claim.¹²⁰

The court of appeals analyzed section 451’s language that the authority “may sue and be sued.”¹²¹ Citing *Missouri Pacific*, the court concluded that the Texas Supreme Court determined that the “sue and be sued” language was a waiver of immunity from suit.¹²² Accordingly, the court concluded that section 451.054 clearly and unambiguously waived Metro’s immunity from suit.¹²³

113. *Id.* at *1-2.

114. *Id.* at *6-7.

115. *Id.* at *4.

116. *Id.* at *6.

117. *Id.* at *6-7.

118. 176 S.W.3d 300 (Tex. App.—Houston [1st Dist.] 2004, pet. filed).

119. *Id.* at 304.

120. *Id.* at 301-02.

121. *Id.* at 302-03.

122. *Id.* at 303-04.

123. *Id.* at 304.

F. NO WAIVER THROUGH “SUE AND BE SUED” LANGUAGE

During 2004 and 2005, the Dallas Court of Appeals stood in contrast to the various other courts of appeal that analyzed the “sue and be sued” language in the construction context. In three separate decisions, the Dallas Court of Appeals refused to find a waiver of immunity from suit as a result of statutory and charter language.

In 2005, in *City of Greenville v. Reeves*,¹²⁴ the Dallas Court of Appeals held that the language in the Texas Government Code and city charter did not clearly and unambiguously waive immunity from suit.¹²⁵ A contractor who provided labor and materials to construct a fire station sued the City of Greenville for failure to pay for work and materials. The city answered and filed a plea to the jurisdiction, asserting immunity from suit.¹²⁶

The contractor argued that Texas Local Government Code section 51.075 waived the city’s immunity from suit in its language that a home-rule municipality “may plead and be impleaded in any court.”¹²⁷ The Dallas court, which had previously ruled that section 51.075 is not a clear and unambiguous waiver of a city’s immunity from suit, reviewed four factors established by the Texas Supreme Court to determine whether the legislature clearly waived immunity: (1) the statute waives immunity beyond doubt; (2) ambiguities are resolved in favor of retaining immunity; (3) if the legislature requires the state be joined in a lawsuit in which immunity would otherwise attach, the legislature has intentionally waived the state’s sovereign immunity; and (4) the statute also provides an objective limitation on the state’s potential liability.¹²⁸

In its decision, the Dallas Court of Appeals noted its prior decisions in which it concluded that section 51.075 is not meaningless without waiver of immunity because it could refer to a city’s capacity to litigate when it waives immunity.¹²⁹ Because the supreme court had not held that the phrase “plead and implead” was a clear and unambiguous waiver of immunity from suit, the court refused to reverse its prior position on waiver and concluded that the city did not waive immunity from suit.¹³⁰ The court similarly concluded that the city charter’s words “sue and be sued” and “plead and be impleaded in all courts” did not waive immunity from suit.¹³¹

Similarly, the Dallas Court of Appeals refused to find waiver in the Government Code and city charter in *City of Greenville v. Sisk Utilities*,

124. 165 S.W.3d 920 (Tex. App.—Dallas 2005, pet. denied).

125. *Id.* at 928.

126. *Id.* at 921.

127. *Id.* at 922.

128. *Id.* at 922 (citing *Wichita Falls State Hosp. v. Taylor*, 106 S.W.3d 692, 697-98 (Tex. 2003)).

129. *Id.* at 925.

130. *Id.* at 923.

131. *Id.*

*Inc.*¹³² Sisk Utilities agreed to perform sewer system work for the City of Greenville. Sisk alleged that the city's improperly performed work caused damages to Sisk. Sisk filed suit against the city, claiming it waived immunity from suit in the Government Code and the city charter.¹³³ Consistent with its prior rulings, the Dallas court refused to find an unambiguous waiver in the statute and city charter.¹³⁴

In 2004, the Dallas Court of Appeals reached a similar conclusion in *City of Carrollton v. McMahon Contracting, LP*.¹³⁵ In that case, the City of Carrollton and McMahon Contracting entered into a contract for street repairs. McMahon sued the city for breach of contract when a payment dispute arose. The city filed a plea to the jurisdiction on the grounds that it enjoyed immunity from suit. The trial court denied the plea, and the city appealed.¹³⁶

The court of appeals reversed, holding that section 51.075 of the Texas Local Government Code did not clearly and unambiguously waive the city's immunity from suit.¹³⁷ McMahon pointed to section 51.075's provision that a home-rule municipality "may plead and be impleaded in any court" to show that there was no immunity from suit.¹³⁸ The court followed the Waco Court of Appeals holding in *City of Mexia v. Tooke*¹³⁹ and concluded that "plead and be impleaded" is not a clear waiver of immunity.¹⁴⁰ The court held that section 51.075 was ambiguous as to whether it addresses a home-rule city's capacity to plead and be impleaded as an entity, or whether it waives immunity from suit.¹⁴¹ The court noted but declined to follow the Houston and Fort Worth courts that held that such language did constitute a clear waiver of immunity from suit.¹⁴²

G. NO WAIVER UNDER TORT CLAIMS ACT FOR GOVERNMENTAL FUNCTION

In *City of Mesquite v. PKG Contracting, Inc.*,¹⁴³ the Dallas Court of Appeals held that a city's governmental functions included overseeing storm sewers and that no waiver for a tort action existed under the Texas Tort Claims Act in the context of such a function.¹⁴⁴ The City of Mesquite contracted with PKG Contracting for construction of a storm drain-

132. 164 S.W.3d 931, 933 (Tex. App.—Dallas 2005, pet. granted).

133. *Id.* at 932.

134. *Id.* at 933.

135. 134 S.W.3d 925, 928 (Tex. App.—Dallas 2004, pet. granted).

136. *Id.* at 926.

137. *Id.* at 928.

138. *Id.* at 927.

139. *Id.*; see *City of Mexia v. Tooke*, 115 S.W.3d 618, 622 (Tex. App.—Waco 2003, pet. granted).

140. *McMahon Contracting*, 134 S.W.3d at 927-28.

141. *Id.*

142. *Id.* at 928.

143. 148 S.W.3d 209 (Tex. App.—Dallas 2004, pet. granted).

144. *Id.* at 213.

age system. During construction, the parties disputed which party was responsible for moving certain utilities from the right-of-way. PKG filed suit against the city, who then filed a plea to the jurisdiction, affirmative defenses, and a general denial. PKG amended its petition to allege that the city had no immunity when it engaged in a proprietary function and that it waived any immunity from suit and liability, citing the city charter and the Local Government Code.¹⁴⁵

The court noted that a governmental unit is immune from tort liability unless the legislature has waived immunity and that waiver does not apply to liability for damages arising from an entity's governmental functions under the Texas Tort Claims Act.¹⁴⁶ PKG asserted that the city had no immunity when it acted in its proprietary capacity and contracted as a private citizen.

The court referenced section 101.0215 of the Tort Claims Act to determine the governmental versus proprietary functions of a city.¹⁴⁷ The court noted that among the list of governmental functions was oversight of "sanitary and storm sewers."¹⁴⁸ Accordingly, it concluded that the contract work was a governmental function and that the Tort Claims Act did not waive immunity from suit for the city.¹⁴⁹ The court refused PKG's argument that it should look to the Tort Claims Act to determine waiver but ignore the Act when determining what was a governmental function.¹⁵⁰ As a final point, the court refused to find waiver through the city charter or through the Texas Local Government Code section 51.075.¹⁵¹

The Dallas Court of Appeals reached a similar conclusion in *Bell v. City of Dallas*.¹⁵² In that case, the Bells purchased a residential lot in Dallas and built a home and pool on it. The lot was subject to an easement for drainage sewers and two storm drains were located on the easement. The Bells began to notice cracks in their pool. Later, the city began a project to improve the storm-drainage system, and it hired a contractor to perform work on that project. The Bells alleged that the contractor caused additional damage to their pool, so they sued the city and the contractor for negligence and other claims.¹⁵³

The city filed a plea to the jurisdiction, asserting governmental immunity. The court determined that storm-sewer maintenance was a governmental function, citing the Tort Claims Act.¹⁵⁴ The Bells argued that

145. *Id.* at 211.

146. *Id.* at 212 (citing TEX. CIV. PRAC. & REM. CODE ANN. ch. 101 (Vernon 1997 & Supp. 2004)).

147. *Id.* at 213.

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.* at 213-14.

152. 146 S.W.3d 819 (Tex. App.—Dallas 2004, no pet.).

153. *Id.* at 821-23.

154. *Id.* at 823 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 101.0215(a)(9) (Vernon Supp. 2005)).

even if the maintenance and operation were governmental functions, the city's alleged promise to fix the drain problems was not. The court rejected the attempt to plead around the Tort Claims Act, concluding that all complained-of actions were governmental functions.¹⁵⁵

H. IMMUNITY FOR CONTRACTORS HIRED BY GOVERNMENTAL ENTITIES

In *GLF Construction Corp. v. LAN/STV*,¹⁵⁶ the Fifth Circuit Court of Appeals, applying Texas law, held that a company performing work on behalf of a public entity was entitled to limited immunity, just as the public entity would have enjoyed.¹⁵⁷ LAN/STV entered into a contract with the Dallas Area Rapid Transit ("DART") to prepare plans, drawings, and specifications for the construction of an extension to Dallas's light-rail system. The engineering contract also required LAN/STV to provide administrative and supervisory services for the project. DART provided the plans to general contractors, who then submitted bids to DART for the construction contract. The contract was awarded to GLF. By virtue of the contracts, DART was in privity with LAN/STV and GLF, but those two entities were not in privity with one another.¹⁵⁸

GLF filed suit against LAN/STV for tort claims of professional negligence. Lacking privity with LAN/STV, it could not assert breach of contract. LAN/STV filed a motion asserting derivative sovereign immunity. It alleged that, as an independent contractor performing DART's functions, it had the same immunity for tort claims as DART would have.¹⁵⁹

The Fifth Circuit cited Texas law that if "an independent contractor of [a transportation] entity is performing a function of the entity or of a regional transportation authority . . . , the contractor is liable for damages only to the extent that the entity or authority would be liable if the entity or authority itself were performing the function."¹⁶⁰ GLF did not dispute that LAN/STV's engineering and supervisory services did fall within DART's functions as a regional authority. Accordingly, the court found that LAN/STV would be liable for damages to GLF "only to the extent" that DART would be liable had it performed the work itself.¹⁶¹

The court then turned to whether DART's sovereign immunity would apply in a tort claim and found that the Texas Tort Claims Act would bar such claims.¹⁶² The court noted that Texas law limits DART's liability both in causes of action for which it may be held liable and in the maxi-

155. *Id.*

156. 414 F.3d 553 (5th Cir. 2005).

157. *Id.* at 557.

158. *Id.* at 555.

159. *Id.*

160. *Id.* at 554 (citing TEX. REV. CIV. STAT. ANN. art. 6550d (Vernon Supp. 2004-2005)).

161. *Id.*

162. *Id.*

imum amount of recovery.¹⁶³ Accordingly, the court concluded that the Act's limitations would apply to LAN/STV and that LAN/STV enjoyed immunity from suit to the extent provided in that statute.¹⁶⁴

By contrast, in *City of Alton v. Sharyland Water Supply Corp.*,¹⁶⁵ the Corpus Christi Court of Appeals rejected the defendant contractor's contention that it was entitled to immunity from suit.¹⁶⁶ In that case, the contractor cited no authority for its derivative immunity claim.¹⁶⁷

I. WAIVER AND ADMINISTRATIVE PROCESS

In *Martin K. Eby Construction Co. v. Dallas Area Rapid Transit*,¹⁶⁸ the Fifth Circuit Court of Appeals required exhaustion of administrative remedies in a construction contract, regardless of whether a public entity waives immunity from suit in a statute or otherwise. Eby and DART entered into a construction contract for a section of DART's light-rail system near downtown Dallas. Eby filed suit against DART, alleging breach of contract and misrepresentation. DART filed a motion to dismiss, arguing that the complaint failed to state a claim for which relief could be granted because Eby did not exhaust its administrative remedies and because the misrepresentation claim would be barred by governmental immunity and the Tort Claims Act.¹⁶⁹

The contract between the parties contained a specific provision requiring all bidders to agree to exhaust all administrative remedies under DART's procurement regulations or the resulting contract's disputes clause. Eby did not submit its claims to the contract's administrative process, but instead alleged that it did complain to DART regarding work problems it faced. The district court granted DART's motion to dismiss both claims.¹⁷⁰

The court noted that the Texas courts generally require a party to exhaust its administrative remedies before seeking judicial review.¹⁷¹ Eby argued that DART's procedures, which were found only in its procurement regulations and the contract, rather than in a statute, were not binding. The Fifth Circuit disagreed, determining that the Texas Supreme Court, if faced with the question, would require the exhaustion of administrative remedies before litigation.¹⁷²

The court also discussed waiver, noting that by contracting with Eby, DART had waived immunity from liability.¹⁷³ The court noted the division among the Texas courts of appeal on the question of whether the

163. *Id.*

164. *Id.* at 557.

165. 145 S.W.3d 673 (Tex. App.—Corpus Christi 2004, pet. denied).

166. *Id.* at 682.

167. *Id.*

168. 369 F.3d 464 (5th Cir. 2004).

169. *Id.* at 465-67.

170. *Id.* at 467.

171. *Id.*

172. *Id.* at 468.

173. *Id.*

“sue and be sued” language in various statutes waives immunity from suit.¹⁷⁴ The Fifth Circuit determined that that question was irrelevant to the case because, even if DART lacked governmental immunity, Eby would still be required to exhaust the administrative remedies.¹⁷⁵ The court noted that the legislature waiving DART’s governmental immunity did not give contractors permission “to sue DART without first submitting their claims to the statutorily authorized administrative process.”¹⁷⁶ The court also disagreed with Eby’s argument that, if DART materially breached the contract, that breach would excuse Eby’s obligation to submit to the administrative process.¹⁷⁷

III. PASS-THROUGH CLAIMS

Before 2004, the Texas courts had not determined whether a contractor liable to a subcontractor for damages that the subcontractor sustained while performing a construction contract could bring a so-called “pass-through claim” against an owner. The Fifth Circuit Court of Appeals certified that question to the Texas Supreme Court, and both the supreme court and various federal and state courts had the opportunity to discuss those issues during 2004 and 2005.

A. THE TEXAS SUPREME COURT’S RULE ON PASS-THROUGH CLAIMS

In *Interstate Contracting Corp. v. City of Dallas*,¹⁷⁸ the Fifth Circuit certified to the Texas Supreme Court questions related to “pass-through” claims to determine Texas law on such issues.¹⁷⁹ In the case before the Fifth Circuit, the City of Dallas contracted with Interstate Contracting Corporation (“ICC”) on a fixed-sum basis for levee construction around a water-treatment plant and related work. ICC formed two subcontracts with Mine Services, Inc. (“MSI”) for some of the work. MSI mixed sand and clay to manufacture work material, which substantially increased the job costs. The contract was silent as to manufacturing fill material. ICC informed the city of MSI’s increased work, but the city indicated that it would deny any additional-compensation claim because the work went beyond the scope of the contract. The contract between ICC and MSI gave ICC the sole discretion to bring a claim against the city on MSI’s behalf at MSI’s expense. Pursuant thereto, ICC filed suit against the city on behalf of MSI.¹⁸⁰

The District Court for the Northern District of Texas allowed ICC to bring the claims. On appeal, the city argued that the judgment was in error because there was no privity between the subcontractor and city.

174. *Id.*

175. *Id.* at 468-69.

176. *Id.* at 469.

177. *Id.* 470-71.

178. 320 F.3d 539 (5th Cir. 2003).

179. *Id.* at 540.

180. *Id.* at 540-43.

ICC argued that, despite a lack of privity, the court correctly permitted ICC to present MSI's claims on a pass-through basis. While the court found support for pass-through claims in actions against the federal government, it found no Texas authority for claims against a state entity.¹⁸¹ Accordingly, the court of appeals asked the Texas Supreme Court to determine if Texas law recognizes pass-through claims; that is, "may a contractor assert a claim on behalf of its subcontractor against the owner when there is no privity of contract between the subcontractor and the owner?"¹⁸²

In *Interstate Contracting Corp. v. City of Dallas*,¹⁸³ the Texas Supreme Court answered two certified questions: (1) whether Texas recognizes pass-through claims, and (2) what requirements must be satisfied in order for a general contractor to assert claims for a subcontractor.¹⁸⁴ As part of its discussion, the supreme court noted that these were difficult issues of first impression for the court, but emphasized privity of contract as a necessary predicate for suit.¹⁸⁵ It concluded that the notions of privity and pass-through claims were compatible and that the court would join the majority of state and federal jurisdictions that permit pass-through claims.¹⁸⁶

The supreme court defined a pass-through claim as a claim (1) by a party that has suffered damages (in this case, a subcontractor); (2) against a responsible party with which it has no contract (here, a city); and (3) presented through an intervening party (here, the contractor) that has a contractual relationship with both.¹⁸⁷ Rather than have two lawsuits (one by the subcontractor against the contractor and a second by the contractor against the owner), a pass-through claim permits a contractor to pursue the subcontractor's claims directly against the owner.¹⁸⁸

In its discussion, the supreme court recognized that, under a typical pass-through arrangement (commonly referred to in the construction industry as a liquidation agreement), a contractor acknowledges liability to a subcontractor, which provides the general contractor with a basis for action against an owner.¹⁸⁹ The contractor's liability is "liquidated" to the extent of its recovery against the owner, and the contractor agrees to convey all or some of its recovery to its subcontractor.¹⁹⁰ In addition, a subcontractor releases all claims it may have against a contractor in exchange for the contractor's promise to pursue the claims against the owner.¹⁹¹

181. *Id.* at 544.

182. *Id.* at 545.

183. 135 S.W.3d 605 (Tex. 2004).

184. *Id.* at 607.

185. *Id.*

186. *Id.*

187. *Id.* at 610.

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

The court also discussed the limitation that a subcontractor generally cannot recover from an owner without privity of contract.¹⁹² The court concluded that a contractor should be allowed to recover costs from the owner regardless of whether the contractor or the subcontractor performed the work.¹⁹³ Otherwise, an owner might receive a windfall simply because of a lack of privity with the subcontractor in question.¹⁹⁴ The court also listed three policy justifications that shaped its decision: (1) recognition of pass-through claims aligns Texas with federal procedure and most states that have considered the issue; (2) pass-through claims protect subcontractors from an owner's breach without undue prejudice to the owner; and (3) pass-through claims promote judicial economy by eliminating unnecessarily duplicative litigation and by encouraging full settlement of claims.¹⁹⁵

With regard to the second question, the supreme court concluded that to support a pass-through claim, the agreement must provide that the contractor remains liable to the subcontractor for its damages.¹⁹⁶ If the owner disputes that liability continues, the owner bears the burden of proving, as an affirmative defense, that the pass-through arrangement eliminates the contractor's responsibility for the subcontractor's damages.¹⁹⁷

As a final point, the supreme court held that a contractor need not admit liability in a binding settlement agreement to support a pass-through claim.¹⁹⁸ Rather, liquidation agreements can be contained in a subcontract or any contract, as long as it provides that the contractor has continuing liability.¹⁹⁹ The court also permitted the agreement to include a "pay if paid" provision, stating that the contractor has no obligation to pay the subcontractor unless and until it recovers from the owner.²⁰⁰

B. FEDERAL AND STATE COURTS' DECISIONS ON PASS-THROUGH CLAIMS

Both before and after the Texas Supreme Court's answers to the certified questions, various federal courts and Texas courts of appeal addressed pass-through claims.

In 2005, the United States District Court for the Northern District of Texas permitted a contractor to assert claims for a subcontractor against the Dallas/Fort Worth Airport Board in *Hensel Phelps Construction Co. v. Dallas/Fort Worth International Airport Board*.²⁰¹ In that case, the

192. *Id.* at 610-11.

193. *Id.* at 616.

194. *Id.* at 618.

195. *Id.* at 619.

196. *Id.*

197. *Id.* at 620.

198. *Id.*

199. *Id.*

200. *Id.*

201. No. 3:03-CV-3043-D, 2005 U.S. Dist. LEXIS 12290 (N.D. Tex. June 22, 2005) (mem. op.).

court concluded that a contractor liable to a subcontractor for damages that the subcontractor sustained can sue an owner for the subcontractor's damages under a pass-through agreement.²⁰² The court went further, holding that when a governmental entity/owner waives immunity from liability by entering into a construction contract with a general contractor, it also waives immunity from liability for all pass-through claims that the contractor may lawfully assert under the contract.²⁰³

Before the Texas Supreme Court's decision in 2004, the San Antonio Court of Appeals also permitted pass-through claims. In *Alamo Community College District v. Browning Construction Co.*,²⁰⁴ the court noted that federal law and other states' laws permit pass-through claims, specifically quoting the United States Supreme Court on its rationale:

Clearly the subcontractor could not recover this claim in a suit against the United States, for there was no express or implied contract between him and the Government. But it does not follow that [the contractor] was the only person legally bound to perform his contract with the Government and he had the undoubted right to recover from the Government the contract price for the tile, terrazzo, marble and soapstone work whether that work was performed personally or through another. This necessarily implies the right to recover extra costs and services wrongfully demanded of [the contractor] under the contract, regardless of whether such costs were incurred or such services were performed personally or through a subcontractor. [The contractor's] contract with the Government is thus sufficient to sustain an action for extra costs wrongfully demanded under that contract.²⁰⁵

In addition, while noting that no Texas case had specifically dealt with pass-through claims, the San Antonio court concluded that such claims were not inconsistent with Texas law.²⁰⁶

IV. CLAIMS ON PERFORMANCE BONDS AND PAYMENT BONDS

During 2004 and 2005, Texas courts considered a variety of questions concerning performance bonds and payment bonds. The Texas Supreme Court reiterated and emphasized its holding that suretyship is not insurance, when it rejected a claim asserted under the Texas Insurance Code against a surety. Other decisions focused on the scope of bonds provided,

202. *Id.* at *13-15.

203. *Id.* at *13-14.

204. 131 S.W.3d 146 (Tex. App.—San Antonio 2004, pet. dism'd).

205. *Id.* at 159 (quoting *United States v. Blair*, 321 U.S. 730, 737-38 (1944)).

206. *Id.* (citing *N. Harris County Junior Coll. Dist. v. Fleetwood Constr. Co.*, 604 S.W.2d 247, 255 (Tex. Civ. App.—Houston [14th Dist.] 1980, writ ref'd n.r.e.) (holding that a contractor could recover for damages related to subcontracted work); *H.B. Zachry Co. v. Ceco Steel Prods. Corp.*, 404 S.W.2d 113, 116 (Tex. Civ. App.—Eastland 1966, writ ref'd n.r.e.) (holding that a contractor has exclusive right and duty to assert the same claim for its subcontractor that it would have asserted for itself had it elected to do the work)).

the compliance with the Texas Property Code, proper notice, material change and discharge, and subrogation and indemnity rights.

A. SURETY BUSINESS IS NOT INSURANCE AND ARTICLE 21.21
DOES NOT APPLY

In *Dallas Fire Insurance Co. v. Texas Contractors Surety & Casualty Agency*,²⁰⁷ the Texas Supreme Court again held that the business of suretyship is not the same as the business of insurance, consistent with its holding in *Great American Insurance Co. v. North Austin Utility District No. 1*.²⁰⁸ In addition, the supreme court made it clear that Article 21.21 of the Texas Insurance Code does not apply to any claims or suits involving the business of suretyship and that the exclusion is not limited strictly to suits between sureties and their bondholders.²⁰⁹ Under the facts of the case, the supreme court concluded that individuals had no Article 21.21 bad-faith claim against either the surety or the insurance agency, because the relationship arose from the business of suretyship and not the "business of insurance."²¹⁰

B. PROPER NOTICES ON A PAYMENT BOND

In *Redland Insurance Co. v. Southwest Stainless, L.P.*,²¹¹ the Fort Worth Court of Appeals concluded that a subcontractor's notice of amount due sent to a contractor by regular mail, rather than certified mail, constituted substantial compliance with the notice requirements of the McGregor Act and Government Code Chapter 2253. In that case, Southwest Stainless was a subcontractor of S.L. Sibert on a construction project for the City of Fort Worth. Redland Insurance Company issued the payment bond required by Chapter 2253. Stainless provided project materials, but Sibert did not pay for them and eventually declared bankruptcy. In the interim, Stainless timely provided notice of its claim to the surety, with a copy to the general contractor.

The court of appeals noted first that, as the McGregor Act is remedial in nature, "it is to be given the most comprehensive and liberal construction possible," and that the Act's notice requirements are satisfied by substantial performance.²¹² Stainless provided testimony that notices of the claim were sent to the contractor by first-class regular mail the same date they were mailed to the surety. Referring to other state court decisions, the court concluded that if substantial compliance with the required information in the notice is satisfactory, then mailing the notice by first-class regular mail, rather than certified mail, was also substantial compli-

207. 159 S.W.3d 895 (Tex. 2004).

208. 908 S.W.2d 415 (Tex. 1995).

209. *Dallas Fire*, 159 S.W.3d at 896-97.

210. *Id.*

211. 181 S.W.3d 509 (Tex. App.—Fort Worth 2005, no pet. h.).

212. *Id.* at 512.

ance and sufficient.²¹³

C. SCOPE OF A BOND CLAIM

In *Harrison, Walker & Harper, L.P. v. Federated Mutual Insurance Co.*,²¹⁴ the Fort Worth Court of Appeals addressed material alteration of a construction contract as a surety discharge and a contractor's standing to sue on a subcontractor's performance bond. In that case, the White Oak Independent School District hired Harrison, Walker & Harper ("HWH") as a general contractor and construction manager for constructing a new cafeteria. HWH hired A&H Electric as a subcontractor for the project's electrical work. A&H obtained performance and payment bonds from Federated, as required by the subcontract. Later, HWH agreed to change the original contract with the school district to include construction of a new library as well. HWH then issued a change order for its subcontract with A&H, adding electrical work for the library in the amount of \$59,000. A&H did not make any changes to its bonds or purchase new bonds.²¹⁵

A&H completed its work on the cafeteria, but defaulted on the library work. HWH provided notice on the bond to Federated and made a \$32,000 demand on it. Federated requested documents to prove the claim, but did not otherwise respond to the demand. HWH then filed suit. Federated argued that HWH did not have standing to sue on the bond, that Federated did not breach any bond obligations because A&H had performed the work that was covered by the bond, and that the library was a material alteration of the contract.²¹⁶ The trial court granted summary judgment for Federated, and the court of appeals affirmed.²¹⁷

First, the court rejected HWH's argument that it was a third-party beneficiary suing for breach of the bond, noting that a third party may enforce and recover on a contract made between other parties "only if the contracting parties intend to secure a benefit to that third party, and only if the contracting parties entered into the contract directly for the third party's benefit."²¹⁸ The court said it would not imply a third-party-beneficiary contract by implication; the agreement must clearly intend to confer a direct benefit to the third party.²¹⁹

The court held that the bond was a contract between Federated, as surety, and A&H, as principal, for the express benefit of the school district, as owner.²²⁰ The face of the bond named the school district as the owner to whom performance was due and did not mention HWH. Ac-

213. *Id.*

214. No. 2-03-048-CV, 2004 Tex. App. LEXIS 2989 (Tex. App.—Fort Worth Apr. 1, 2004, no pet.).

215. *Id.* at *2.

216. *Id.* at *3-4.

217. *Id.* at *2.

218. *Id.* at *4.

219. *Id.*

220. *Id.* at *6.

cordingly, the terms of the bond made the school district a creditor beneficiary, but did not make HWH any type of third-party beneficiary.²²¹ Therefore, the court concluded that HWH had no standing to sue on the bond.²²²

Additionally, the court noted that the doctrine of *strictissimi juris* applies to a surety bond in order to prevent the extension a guarantor's implied obligation beyond the original agreement.²²³ When a creditor and principal debtor vary in any material degree from the terms of their contract, a new contract is formed and a guarantor is not bound to it.²²⁴ The court concluded that the bond applied to cafeteria work only, and that the bond was discharged with the performance on the cafeteria.²²⁵ The changes in the scope of work to include the library was a material change and constituted a new contract, for which Federated was not bound.²²⁶

D. COMPLIANCE WITH PROPERTY CODE

In *Laughlin Environmental, Inc. v. Premier Towers, L.P.*,²²⁷ Houston's Fourteenth District Court of Appeals concluded that a payment bond that did not satisfy the requirements of the Texas Property Code would not protect real property from a lien asserted by a subcontractor.²²⁸ JPF Holdings, the property owner, contracted for \$1.295 million with Vanco Insulation Abatement for abatement work in Houston. Vanco, as principal, and United Pacific Insurance Company, as surety, executed the performance and payment bonds for the project. Vanco's subcontractor, Laughlin Environmental, alleged that it was not paid for its work. Laughlin timely filed a lien affidavit asserting a mechanic's and materialman's lien against the property. JPF conveyed the property to a new owner. Laughlin sued the surety, JPF, and the new owner, seeking to recover on the bond or foreclose the lien.²²⁹

The question presented to the court was whether the payment bond satisfactorily complied with Texas Property Code section 53.211 and therefore would protect against liens to the real property and the subsequent owner.²³⁰ The court noted that Texas is one of the few states with a statutory form of payment bond for a private contract.²³¹ The court recited that such a bond must meet the criteria set forth in section 53.202 of the Property Code, be approved by the owner, and be filed in accordance

221. *Id.*

222. *Id.*

223. *Id.* at *7.

224. *Id.*

225. *Id.* at *9.

226. *Id.*

227. 126 S.W.3d 668 (Tex. App.—Houston [14th Dist.] 2004, no pet.).

228. *Id.* at 669-70.

229. *Id.* at 670.

230. *Id.*

231. *Id.* at 671.

with the Property Code.²³²

The court noted that the Texas Property Code does not require perfect compliance, but attempted compliance or evidence of intent to comply is sufficient.²³³ The court noted that, “in civil cases, an ‘attempt’ ordinarily means ‘an intent combined with an act falling short of the thing intended.’”²³⁴ The court analyzed the bond and determined that it was not conditioned on prompt payment for labor and materials, did not recite or refer to the Property Code or its requirements, did not contain the proper penal sum for the bond, and had other shortcomings.²³⁵ The court concluded that the bond did not satisfy the Texas Property Code requirements, and the subcontractor’s assertion of a lien was not barred by the bond’s existence.²³⁶

E. RETAINAGE IS PROPERTY OF SURETY, NOT BANKRUPTCY ESTATE

In *American States Insurance Co. v. United States*,²³⁷ the United States District Court for the Northern District of Texas concluded that retainage withheld from a subcontractor that defaulted on its performance belonged to the completing surety, not the subcontractor’s bankruptcy estate.²³⁸ In that case, SSEM subcontracted with Manhattan Construction, which was the general contractor on a construction project for the City of Dallas Convention Center Expansion and Renovation Project. ASIC, as surety, issued both payment and performance bonds on behalf of SSEM. SSEM performed some work on the project, then defaulted, and later declared bankruptcy.²³⁹

Manhattan withheld over \$88,000 of contract monies from SSEM during its work, under the terms of the parties’s agreement. When Manhattan made demand upon ASIC to complete work for SSEM, ASIC expended more than \$430,000 to complete the contract.²⁴⁰

The IRS, as one of the primary creditors of SSEM, filed a motion for relief from the automatic stay, seeking to recover the retainage from Manhattan. It argued that the funds were property of the SSEM estate and that the IRS had a priority claim on them.²⁴¹ ASIC filed a competing motion, arguing that it was entitled to the retainage under its equitable subrogation rights and that SSEM had not earned the retainage and had therefore never become part of the estate.²⁴²

After analyzing case law, the subcontract, and the Bankruptcy Code, the court concluded that the surety’s interest prevented the retainage

232. *Id.*

233. *Id.*

234. *Id.* at 672 (quoting BLACK’S LAW DICTIONARY 116 (5th ed. 1979)).

235. *Id.* at 673-75.

236. *Id.* at 675-76.

237. 324 B.R. 600 (N.D. Tex. 2005) (mem. op.).

238. *Id.* at 607.

239. *Id.* at 601-02.

240. *Id.*

241. *Id.* at 602.

242. *Id.*

from becoming the bankruptcy estate's property.²⁴³ The court also concluded that the nature of the surety's right was not a claim but an ownership interest.²⁴⁴ The court noted that Texas law regarding the nature of a surety's equitable subrogation interest indicates that it is not simply a claim or a lien.²⁴⁵

F. RECOVERY ON INDEMNITY AGREEMENT

In *United States Fire Insurance Co. v. Rey-Bach, Inc.*,²⁴⁶ the United States District Court for the Northern District of Texas granted summary judgment in favor of a surety on claims against indemnitors on two bonds issued in connection with school construction.²⁴⁷ The court ruled that, as a matter of law, the indemnitors had breached the duty to indemnify the surety and had committed conversion with regard to contract funds that the contractor received but failed to pay to subcontractors.²⁴⁸ The court said that the indemnitors had a heavy burden to avoid summary judgment in a claim for indemnification; they had to defeat the contract's provision that an itemized statement of payments, losses, and attorneys' fees sworn to by surety officer would constitute prima facie evidence of the indemnitors's liability.²⁴⁹

V. ARBITRATION CLAUSES AND RIGHTS

During 2004 and 2005, the Texas courts continued to issue decisions concerning arbitration provisions, by interpreting and applying 2003 Texas Supreme Court decisions. In 2003, the supreme court handed down three decisions upholding arbitration limits. In *Callahan & Associates v. Orangefield Independent School District*,²⁵⁰ the supreme court outlined the extremely limited authority that a trial or appeals court has in reviewing an arbitration award.²⁵¹ In *CVN Group, Inc. v. Delgado*,²⁵² the court emphasized the binding nature of arbitration and refused to reverse an arbitrator's award, even though a court of appeals found the award erroneous under Texas law.²⁵³ In *In re First Texas Homes, Inc.*,²⁵⁴ the supreme court strictly enforced an arbitration agreement's scope in a construction contract.²⁵⁵

243. *Id.* at 605.

244. *Id.* at 607.

245. *Id.* at 606-07.

246. No. 3:02-CV-2133-K, 2004 U.S. Dist. LEXIS 16237 (N.D. Tex. Aug. 15, 2004).

247. *Id.* at *10-11.

248. *Id.* at *7, *10-11.

249. *Id.* at *6.

250. 92 S.W.3d 841 (Tex. 2002).

251. *Id.* at 844.

252. 95 S.W.3d 234 (Tex. 2002).

253. *Id.* at 243.

254. 120 S.W.3d 868 (Tex. 2003).

255. *Id.* at 870.

During the last two years, the courts of appeal have decided when non-signatories are required to arbitrate, as well as other limits on the power to review arbitration decisions.

A. NONSIGNATORIES CAN BE BOUND BY ARBITRATION PROVISIONS

In *Associated Glass, Ltd. v. Eye Ten Oaks Investments, Ltd.*,²⁵⁶ the San Antonio Court of Appeals conditionally granted mandamus relief compelling arbitration to two subcontractors being sued by developer Eye Ten Oaks in a construction- and design-defects dispute.²⁵⁷ The subcontractors did not have contracts directly with the developer, but their contracts with the general contractor contained identical arbitration provisions. The court sought to determine whether Eye Ten Oaks was attempting to assert claims that relied on the contracts between the subcontractors and the general contractor.²⁵⁸ If the developer was relying on the underlying contracts, it could be bound by the arbitration provision.²⁵⁹

To determine whether the developer was relying on the underlying contracts, the court had to determine if the claims were “so interwoven with the contract that [they] cannot stand alone.”²⁶⁰ If so, then the claim would require arbitration.²⁶¹ If the claims were “completely independent” of the contracts between the subcontractors and the general contractor and “could be maintained without reference to the contract,” then the arbitration agreements between the subcontractors and the general contractor would not bind the non-signatory.²⁶²

The court found that each of the allegations arose out of or related to the duties and obligations created by the subcontracts.²⁶³ And because “a party may not avoid broad language in an arbitration clause by attempting to cast complaints in tort rather than contract,” the court held that Eye Ten was bound by the arbitration provisions of the subcontracts and that all of Eye Ten’s factual allegations fell within the scope of the arbitration provision.²⁶⁴

Similarly, in *Cappadonna Electrical Management v. Cameron County*,²⁶⁵ the Corpus Christi Court of Appeals granted mandamus relief to compel Cameron County to arbitrate a dispute with two subcontractors that arose out of new prison facility construction.²⁶⁶ Claiming negligence, negligence per se, breach of express warranty, and breach of fiduciary duty, the county sued both the general contractor and the sub-

256. 147 S.W.3d 507 (Tex. App.—San Antonio 2004, no pet.).

257. *Id.* at 514.

258. *Id.* at 512-13.

259. *Id.* at 512.

260. *Id.* at 513.

261. *Id.*

262. *Id.*

263. *Id.*

264. *Id.*

265. 180 S.W.3d 364 (Tex. App.—Corpus Christi 2005, no pet. h.).

266. *Id.* at 369-70.

contractor.²⁶⁷ The trial court denied the subcontractor's motion to compel arbitration, granted the contractor's motion to compel arbitration, and severed the claims against the subcontractors from those against the contractor.²⁶⁸

The subcontractors filed both a request for mandamus and an interlocutory appeal.²⁶⁹ They offered two theories—incorporation by reference and equitable estoppel—for why the county should be bound to the subcontracts' arbitration provisions.²⁷⁰ Ultimately, the court denied the subcontractors relief under incorporation by reference, but granted mandamus under equitable estoppel.²⁷¹

Incorporation by reference occurs when two or more contracts become part of a single contract because one contract refers to another.²⁷² The trial court found that the subcontract was not part of the prime contract between the county and the general contractor.²⁷³ The court of appeals agreed, finding that the intent of the parties to the general contract was to specifically disclaim any contractual relationship between the county and the subcontractors.²⁷⁴ Thus, the court of appeals found that a non-signatory third party cannot be compelled to arbitrate through incorporation by reference if the party neither signed the agreement nor incorporated it into a contract that it did sign.²⁷⁵ That is, a party cannot unilaterally bind a third party to an agreement through the doctrine of incorporation by reference.

The subcontractors fared better under the theory of equitable estoppel. The court recognized two circumstances under which a non-signatory can compel a signatory to arbitrate claims between them: "(1) when the signatory has raised allegations of substantially interdependent and concerted misconduct by both the non-signatory and one or more of the signatories to the contract; or (2) when the nature of the signatory's claims against the non-signatory requires reliance on the agreement containing an arbitration provision."²⁷⁶ That is, if the non-signatory attempts to directly benefit from the contract by enforcing the terms of the contract against one of the signatories, then the non-signatory is bound to arbitrate if the

267. *Id.* at 373-75.

268. *Id.* at 368-69.

269. Mandamus is the proper remedy for a denial of a motion to compel arbitration arising out of the Federal Arbitration Act, whereas an interlocutory appeal is the proper course for a denial under the Texas Arbitration Act. The Texas Supreme Court has instructed courts of appeal to consolidate such proceedings and render a decision that disposes of both simultaneously. *Id.* at 369; see *In re Valero Energy Corp.*, 968 S.W.2d 916, 917 (Tex. 1998).

270. The Texas Supreme Court recognizes six theories for binding a non-signatory to an arbitration provision: (1) incorporation by reference; (2) assumption; (3) agency; (4) alter ego; (5) equitable estoppel; and (6) third-party beneficiary. *Cappadonna*, 180 S.W.3d at 370-71; see *In re Kellogg, Brown & Root*, 166 S.W.3d 732, 739 (Tex. 2005).

271. *Cappadonna*, 180 S.W.3d at 373-75.

272. *Id.* at 370-71.

273. *Id.* at 371.

274. *Id.* at 372.

275. *Id.* at 372-73.

276. *Id.* at 373.

contract contains an arbitration provision.²⁷⁷

The question of whether a non-signatory attempted to derive a direct benefit from the contract's enforcement is a highly fact-specific inquiry.²⁷⁸ A party attempts to derive a direct benefit when it seeks to exploit not just the relationship between the signatories, but also the rights and duties of the contract itself.²⁷⁹ Or, as the Texas Supreme Court said, "when a nonparty consistently and knowingly insists that others treat it as a party, it cannot later turn its back on the portions of the contract, such as an arbitration clause, that it finds distasteful. A nonparty cannot both have its contract and defeat it too."²⁸⁰

In this case, the county sought damages for breach of fiduciary duty arising out of the subcontracts, and it implied that the subcontractors and the county were in a contractual relationship through the contract between the county and the general contractor.²⁸¹ By framing its petition so as to imply that the subcontractors had a contractual relationship with the county, the county was exploiting not just the contractual relationship between the subcontractors and the general contractor, but the subcontracts themselves.²⁸² Such exploitation of the subcontract's obligations gives rise to the so-called direct-benefits equitable estoppel.²⁸³

B. CONDITIONS PRECEDENT MUST BE SATISFIED

The Corpus Christi Court of Appeals heard another mandamus proceeding, this one requesting that a subcontract's contingent arbitration provision be given effect against the general contractor. In *Alpha Masonry, Inc. v. Peterson Construction, Inc.*,²⁸⁴ the appellant-subcontractors appealed a denial of their motions to compel arbitration in separate suits between them and Peterson, the general contractor.²⁸⁵ The subcontracts contained an arbitration provision that was contingent on the general contract between the contractor and developer having an enforceable arbitration provision between the contractor and the developer. Because the trial court previously denied Peterson's motion to compel arbitration against the developer and because the court of appeals denied Peterson's petition for writ of mandamus, the court of appeals in the suit between Peterson and the developer tacitly decided that the general contract did

277. *Id.*

278. *See id.* at 373-74.

279. *Id.*

280. *Id.* (citing *In re Weekley Homes*, No. 04-0119, 2005 Tex. LEXIS 989, at *23 (Tex. Oct. 28, 2005)).

281. The county's claim contained the following language (Landmark was the general contractor): "Landmark and the [Subcontractors] are subsequently liable under their agreement with the County. Landmark and the [Subcontractors] failed to strictly comply with the agreement and are liable for damages proximately caused by such breach." *Id.* at 374.

282. *Id.* at 374-75.

283. *Id.*

284. No. 13-04-641-CV, 2005 Tex. App. LEXIS 352 (Tex. App.—Corpus Christi Jan. 18, 2005, pet. denied).

285. *Id.* at *1-3.

not contain an enforceable arbitration provision.²⁸⁶ Thus, the subcontract's arbitration-provision condition precedent was not met, and the subcontractors' petitions for writ of mandamus were denied.²⁸⁷

C. UNCONSCIONABILITY

In *Pine Ridge Homes, Inc. v. Stone*,²⁸⁸ the Dallas Court of Appeals determined that an arbitration provision in a residential-home contract is unconscionable when, in light of the parties' available remedies and the general commercial background and needs of the parties, it "grossly favors" one party over the other.²⁸⁹ The Stones entered into a new-home contract with Pine Ridge that contained several provisions favoring Pine Ridge. The contract provided that it was contingent on the Stones obtaining construction financing. The lender was willing to make the loan if Pine Ridge would agree to a ten-percent retainage pending final inspection. Pine Ridge refused to alter its draw schedule, and the lender denied the Stones' loan application. The Stones cancelled the contract and demanded the return of their earnest money, which Pine Ridge also refused.²⁹⁰

The contract's arbitration provision required that the party submitting the arbitration demand pay the other party's arbitration costs.²⁹¹ The American Arbitration Association ("AAA") deemed this provision to be a "material or substantial deviation" from its Consumer Rules and Protocol.²⁹² The AAA would only administer the dispute if Pine Ridge agreed to waive that provision and pay its own fee, but Pine Ridge refused.²⁹³ The Stones then filed suit in district court, and Pine Ridge motioned the court to compel arbitration. The trial court denied the motion, holding *inter alia* that the arbitration provision was unconscionable because it required the Stones to pay all arbitration fees.²⁹⁴

The court of appeals agreed.²⁹⁵ The Stones' only remedy under the contract was return of their earnest money, and the only way they could obtain it was to demand arbitration.²⁹⁶ Pine Ridge, on the other hand, retained its right to seek any remedies allowed by law.²⁹⁷ In addition, the court found that the contract was on a pre-printed form and that the arbitration provision was contrary to the AAA's due-process protocol.²⁹⁸ Fi-

286. *Id.* at *10.

287. *Id.* at *10-11.

288. No. 05-04-00002-CV, 2004 Tex. App. LEXIS 6979 (Tex. App.—Dallas Aug. 3, 2004, no pet. h.).

289. *Id.* at *7-8.

290. *Id.* at *2-3.

291. *Id.* at *2.

292. *Id.* at *4.

293. *Id.*

294. *Id.* at *4-5.

295. *Id.* at *7.

296. *Id.* at *8.

297. *Id.*

298. *Id.* at *7.

nally, and most importantly, Pine Ridge could keep the Stones' earnest money.²⁹⁹ "It thus had a remedy without resort to arbitration or being required to pay any fees."³⁰⁰ Therefore, the court found that, although the arbitration clause appeared to apply equally to both parties, "a review of the agreement in the light of the remedies available shows it grossly favored Pine Ridge."³⁰¹

D. NOTICE PROVISIONS DO NOT CREATE BINDING AGREEMENT

A construction defect notice provision similar to that required in section 27.007 of the Texas Property Code did not bind the parties to arbitrate construction-defect claims in *Bates v. MTH Homes-Texas, L.P.*³⁰² Bates sued MTH Homes for construction defects that occurred during the construction of the Bates' new home. When MTH's motion to compel arbitration was granted, the Bates' appealed and filed a petition for writ of mandamus.³⁰³

The clause at issue was contained in the earnest-money-contract addendum to the general contract and stated: "[T]he purchaser must provide notice regarding the defect to the builder by certified mail, return receipt requested, not later than the 60th day before the date the purchaser initiates a claim to recover damages in an arbitration proceeding."³⁰⁴ The court found that this provision was substantially similar to Texas Property Code section 27.007, except that the Code's provision stated that notice had to be given "before the date you file suit to recover damages in a court of law or initiate arbitration."³⁰⁵ MTH argued that this clause showed the Bates' intent to arbitrate their construction defect claims.³⁰⁶ The court of appeals disagreed, finding that the language was not sufficiently express, plain, clear, and certain of the party's intent.³⁰⁷ The better interpretation, according to the court, was that *if* the Bates decided to seek damages in an arbitration proceeding, then they had to give the builder sixty-days' notice.³⁰⁸ And because a party cannot be bound to arbitrate unless it expressly agrees to do so, the Bates' petition was conditionally granted, and the trial court was ordered to vacate its order compelling arbitration.³⁰⁹

E. GOVERNMENT ENTITIES AND ARBITRATION

In *Gene Duke Builders, Inc. v. Abilene Housing Authority*,³¹⁰ the East-

299. *Id.* at *8.

300. *Id.*

301. *Id.*

302. 177 S.W.3d 419 (Tex. App.—Houston [1st Dist.] 2005, no pet. h.).

303. *Id.* at 421.

304. TEX. PROP. CODE ANN. § 27.007 (Vernon Supp. 2004-2005).

305. *Bates*, 177 S.W.3d at 423.

306. *Id.*

307. *Id.* at 424.

308. *Id.*

309. *Id.* at 424-25.

310. 168 S.W.3d 215 (Tex. App.—Eastland 2005, pet. filed).

land Court of Appeals held that Texas Government Code Chapter 2260, which establishes administrative procedures for disputes between individuals and governmental units, does not apply to municipal housing authorities, which are amenable to suit or arbitration if provided for by contract.³¹¹ Gene Duke Builders, Inc. ("Duke") contracted with the Abilene Housing Authority ("AHA") to repair housing units in Abilene. Duke filed a claim with the construction administrator after a dispute arose concerning payment and completion of the project. AHA denied Duke's claim, and Duke demanded arbitration pursuant to its contract with AHA. When AHA refused, Duke sued to enforce the arbitration clause. The trial court originally ordered the parties to arbitration, but when the AHA filed a plea to the jurisdiction asserting that it was a state-government unit under Texas Government Code Chapter 2260, the trial court vacated its arbitration order and dismissed the case for lack of subject matter jurisdiction.³¹² Thus, the court of appeals sought to determine whether a housing authority is a unit of state government under the Texas Government Code.³¹³ If a housing authority is a unit of state, as opposed to local government, then the trial court would indeed lack subject matter jurisdiction pursuant to Texas Government Code Chapter 2600.³¹⁴ Finding no authority that it was a unit of state government rather than local government, the court held that Chapter 2600 did not apply and that the trial court had jurisdiction to order arbitration.³¹⁵ The court reinstated the order to arbitrate.³¹⁶

F. CHALLENGES TO ARBITRATION AWARDS

The case of *Anchor Paving Co., Inc. v. Wood Electrical Services, Inc.*³¹⁷ raised the issue of whether, upon receiving an arbitration award, a party should file a summary-judgment motion or a motion to confirm the award.³¹⁸ Wood filed suit to confirm an arbitration award against Anchor. Anchor filed counterclaims seeking to have the award vacated, corrected, or modified on the ground that the arbitrator committed willful misconduct in refusing to grant Anchor additional time to subpoena

311. *Id.* at 219. Chapter 2260 of the Texas Government Code established administrative procedures controlling disputes between individuals and units of state government.

312. *Id.* at 217.

313. *Id.* at 218.

314. *See* TEX. GOV'T CODE ANN. ch. 2260 (Vernon 2001).

315. *Gene Duke Builders*, 168 S.W.3d at 220. The court surveyed the Texas Local Government Code and found that a housing authority (a) cannot operate until a municipality governing body declares it necessary by a resolution (TEX. LOC. GOV'T CODE ANN. § 392.011(c)); (b) is geographically limited to the municipality that created it (TEX. LOC. GOV'T CODE ANN. § 392.014); and (c) is not governed by the state, but rather by the presiding officer of the municipality's governing body (TEX. LOC. GOV'T CODE ANN. § 392.031(a)). The court also found that according to the Dallas Court of Appeals, a municipal housing authority is a unit of city government, created by and existing only with the consent of the city.

316. *Gene Duke Builders*, 168 S.W.3d at 222.

317. No. 14-03-00224-CV, 2004 Tex. App. LEXIS 8748 (Tex. App.—Houston [14th Dist.] Sept. 30, 2004, no pet.).

318. *Id.* at *1.

three witnesses during the arbitration.³¹⁹ Wood then filed a no-evidence motion for summary judgment that the trial court granted, entering judgment for Wood in the amount of damages the arbitrator determined and denying Anchor's counterclaims.³²⁰

On appeal, Anchor argued that, because Wood filed a no-evidence summary-judgment motion, the court was precluded from examining evidence that the arbitrator granted Anchor three rescheduling requests before arbitration began.³²¹ The court agreed, holding that a no-evidence summary judgment can only be sustained if the nonmovant cannot come forward with more than a scintilla of evidence.³²² The court found that it could only examine Anchor's evidence that Wood did not allow it to subpoena three additional witnesses, and it found sufficient evidence to reverse the trial court; "An arbitrator can commit misconduct by preventing a party from presenting evidence."³²³ In dicta, the court noted that had Wood filed a motion to confirm the arbitration award, the court could have examined and considered "all the evidence and could have indulged all reasonable presumptions in favor of the award, just as the trial court would have."³²⁴

VI. MECHANIC'S & MATERIALMAN'S LIENS

During 2004 and 2005, the Texas courts issued several opinions regarding mechanic's lien rights under the Texas Constitution and the Texas Property Code. The decisions focused on issues such as the owners' role in creating liens, notice requirements under the Property Code, protection of homestead property, services that qualify for liens, fraudulent liens, and limitations on liens.

A. CONTRACT WITH ACTUAL OWNER REQUIRED

Absent an agency relationship or equitable considerations, the legal owners of real property cannot be bound to a contract that an equitable owner makes that fixes a lien on his or her interest in the property.³²⁵ This was the holding of *Gibson v. Bostick Roofing & Sheet Metal*, in which the El Paso Court of Appeals reversed the trial court's grant of Bostick's request to foreclose on a mechanic's and materialman's lien against Gibson. The lien was allegedly created by a contract to repair the roof between Bostick and Brown, who was an equitable owner of an apartment complex legally owned by Gibson.³²⁶ Brown had represented to Bostick that he owned the complex and that insurance would cover the

319. *Id.* at *3.

320. *Id.*

321. *See id.* at *4.

322. *Id.* at *4-5.

323. *Id.* at *9.

324. *Id.* at *11 n.5.

325. *See Gibson v. Bostick Roofing & Sheet Metal*, 148 S.W.3d 482 (Tex. App.—El Paso 2004, no pet.).

326. *Id.* at 495.

repair costs. Although insurance covered the repair costs, Brown had forged Gibson's signature and cashed the checks.³²⁷ When Bostick learned that Gibson was the complex's legal owner, he notified Gibson of the lien and filed suit against him and Brown.³²⁸ The trial court found that Gibson admitted that Brown was an owner who had the authority to contract with Bostick and that Gibson was unjustly enriched and indebted to Bostick in the amount of the repair costs plus attorney's fees, and it allowed foreclosure on Bostick's mechanic's and materialman's lien.³²⁹

The court of appeals reversed, finding that Bostick could not recover from Gibson and could not foreclose against Gibson's property based on either *quantum meruit* or sworn account theories.³³⁰ The court found that Bostick's *quantum meruit* claim failed because Bostick testified that he undertook the work for Brown's benefit rather than Gibson's.³³¹ In addition, the court held that a third party or stranger to an agreement cannot be held liable under a sworn account, even in the absence of a written denial under oath.³³²

Finally, the court of appeals considered whether Gibson was bound to the contract for services under Bostick's agency theory.³³³ A finding of either actual or apparent authority would bind Gibson to the repair contract between Brown and Bostick and would subject the property to either a constitutional or statutory lien.³³⁴

The court reviewed case law interpreting Article 16, section 37 of the Texas Constitution, which states: "Mechanics, artisans and material men, of every class, shall have a lien upon the buildings and articles made or repaired by them for the value of their labor done thereon, or material furnished therefore."³³⁵ The court found that Texas courts have consistently held that a lien is created only when the property owner contracts for repairs and the original contractor files suit.³³⁶ The court found further that no privity of contract existed between Bostick and Gibson and that Brown had neither actual nor apparent authority to obligate Gibson.³³⁷ Therefore, the court concluded that Brown could not fix a consti-

327. *Id.* at 488.

328. *Id.* at 487.

329. *Id.* at 487.

330. *Id.* at 496.

331. *Id.*

332. *Id.*

333. *Id.* at 491-92.

334. *Id.* at 491.

335. *Id.* at 493 (citing TEX. CONST. art. 16, § 37).

336. *Id.* at 493 (citing *Rhoades v. Miller*, 414 S.W.2d 942, 944 (Tex. Civ. App.—Tyler 1967, no writ), *Berger Eng'g Co. v. Village Casuals, Inc.*, 576 S.W.2d 649, 652 (Tex. Civ. App.—Beaumont 1978, no writ), and *Wiseman Hardware Co. v. R. L. King Const. Co.*, 387 S.W.2d 79, 81 (Tex. Civ. App.—Dallas 1965, no writ)). The court also looked at whether Bostick was an original contractor or a subcontractor, but the court did not decide the issue. *Id.* at 494.

337. *Id.* at 492-94.

tutional lien on the property.³³⁸

A statutory lien is created under Texas Property Code section 53.001, if “(2) the person labors, specially fabricates the material, or furnishes the labor or materials under or by virtue of a contract with the owner or the owner’s agent, trustee, receiver, contractor, or subcontractor.”³³⁹ Unlike the constitutional lien, the statutory mechanic’s lien can attach “to the interest of the person contracting for construction.”³⁴⁰ That is, a mechanic’s lien can be fixed to an equitable interest in the property if the equitable owner makes the contract.³⁴¹ However, the lien expires once the equitable interest expires.³⁴² Such was the case here. In December 1995, Brown quitclaim deeded his interest in the property back to Gibson, thereby extinguishing the equitable interest.³⁴³ Thus, the court concluded that there was no legal basis to find that Bostick could, either constitutionally or via statute, affix a lien on Gibson’s interest in the apartment complex, and it reversed and rendered judgment that Bostick take nothing against Gibson.³⁴⁴

B. NOTICE REQUIREMENTS

In *The New AAA Apartment Plumbers, Inc. v. DPMC-Briarcliff, L.P.*,³⁴⁵ the Corpus Christi Court of Appeals held that the notice requirement of Texas Property Code section 53.055(a) was satisfied, even though the lien affidavit’s filing notice was sent before the affidavit was filed.³⁴⁶ This reversed the trial court’s determination that, as a matter of law, AAA had failed to perfect its lien because it sent notice before filing the lien affidavit.³⁴⁷ Called upon to interpret the language of section 53.055(a), the court found that “mechanic’s and materialman’s statutes are to be liberally construed for the purpose of protecting laborers and materialmen.”³⁴⁸ The court further found that “substantial compliance with the relevant sections of the property code is sufficient to perfect a mechanic’s and materialman’s lien.”³⁴⁹ Thus, AAA’s system of lien notification, which resulted in notice being sent days before the affidavit was filed, did not preclude it from meeting the section 53.055(a) requirements, which states: “[a] person who files an affidavit must send a copy of the affidavit by registered or certified mail to the owner *not later than* the fifth day after the date the affidavit is filed with the county clerk.”³⁵⁰

338. *Id.* at 494.

339. TEX. PROP. CODE ANN. § 53.021(a)(2) (Vernon 2005).

340. *Gibson*, 148 S.W.3d at 495.

341. *Id.* A lien can also attach to a leasehold interest if a lessee contracts for construction. *Id.*

342. *Id.*

343. *Id.*

344. *Id.* at 495-96.

345. 145 S.W.3d 728 (Tex. App.—Corpus Christi 2004, no pet.).

346. *Id.* at 731.

347. *Id.*

348. *Id.* at 730.

349. *Id.*

350. *Id.* (emphasis in original).

AAA's notice was not otherwise deficient and met the requiring notice's purpose, which is "to ensure that a property owner will not be ambushed by recorded liens."³⁵¹ The dissent said that it would not have read the statute so expansively.³⁵²

The perfection and notice requirements of the Texas Government Code Chapter 2253.041, section 253.073 were at issue in *Capitol Indemnity Corp. v. Kirby Restaurant Equipment & Chemical Supply Co.*³⁵³ Kirby provided labor and materials for a public-works project for which Capitol had issued a payment bond under Texas Government Code section 2253.001(a), and, when it had not been paid, it sought payment under the bond.³⁵⁴ Under cross motions for summary judgment, the trial court ruled in favor of Kirby.³⁵⁵ On appeal, Capitol challenged only the court's finding that Kirby had perfected its claim and provided sufficient notice under sections 2253.041 and 2253.073.³⁵⁶

Section 2253.073 requires that a beneficiary under a payment bond properly perfect its claim before bringing suit.³⁵⁷ Perfection requires notice, which, under section 2253.041(a), requires that the beneficiary mail a written notice to the primary contractor and to the surety.³⁵⁸ Notice must be "accompanied by a sworn statement of account that states in substance: (1) the amount claimed is just and correct; and (2) all just and lawful offsets, payments, and credits known to the affiant have been allowed."³⁵⁹ Kirby mailed a letter to Capitol that contained a sworn document entitled "Application and Certificate for Payment." The letter stated that it was intended to provide notice of non-payment, and the sworn Application and Certificate for Payment indicated the amount due, that the work had been "completed in accordance with the Contract Document," and that the Contractor paid all amounts due for work for which previous Certifications for Payment were issued and payments received from the Owner. . . .³⁶⁰ The court held that the sworn document need not strictly conform to the specific language of section 2253.041(c).³⁶¹ The court found that language indicating that the work was completed according to the contract was sufficient to show that the charges were "just and correct."³⁶² In addition, the statement in Kirby's sworn document that the contractor paid for all other work and needed only to pay the present amount suggested that "all just and lawful offsets, payments, and credits known to the affiant have been allowed."³⁶³ Therefore, the

351. *Id.*

352. *Id.* at 731.

353. 170 S.W.3d 144 (Tex. App.—San Antonio 2005, pet. denied).

354. *Id.* at 146-47.

355. *Id.* at 146.

356. *Id.*

357. *Id.* at 147.

358. *Id.*

359. *Id.* See TEX. GOV'T CODE ANN. § 2253.041(c) (Vernon 2005).

360. *Capitol*, 170 S.W.3d at 147.

361. *Id.* at 147-48.

362. *Id.*

363. *Id.*

court held that the purposes of the statute—to provide the surety with “knowledge of the substance of the claim” and to give those who furnish labor and materials “a simple and direct method of providing notice of their claim”— were met with Kirby’s letter.³⁶⁴ The court affirmed the trial court’s judgment for Kirby and dismissed Capitol’s points of error.³⁶⁵

In *Wesco Distribution, Inc. v. Westport Group, Inc.*, the Austin Court of Appeals affirmed the trial court’s ruling that Wesco’s lien was invalid due to improper notice.³⁶⁶ Wesco provided materials for a dental-office project on which Westport was the general contractor. Westport’s subcontractor, J&D Electric, failed to pay Wesco for the materials, and “Wesco attempted to send notice by mail to Westport” of the outstanding bill. The notice was returned for inadequate postage. Wesco had until July 15, 2001 to notify Westport, but because its notice was returned, Westport did not receive notice until after July 25, 2001. In the period between Wesco sending the first and second notice, Westport, having no notice of Wesco’s lien, paid J&D Electric. Thus, the question before the court was whether Wesco’s original notice met the statutory requirements of Texas Property Code section 53.056(b), regardless of whether Westport received it on time.³⁶⁷ The court agreed with Westport’s argument that “sending” notice by mail “necessarily includes attaching sufficient postage.”³⁶⁸ Although the court acknowledged that it had to liberally construe the Property Code’s mechanic’s and materialman’s liens provisions, it found that if the legislature intended sufficient postage to not be required, Wesco’s lien would be enforceable without resending notice and without Westport ever actually receiving notice.³⁶⁹ The court said that this would be an absurd result.³⁷⁰ Additionally, because the notice requirement “plays a critical role” in the mechanic’s- and materialman’s-lien statutes, “substantial compliance” that did not result in timely written notice would do violence to the statute.³⁷¹ Thus, the court affirmed trial court’s judgment that the lien was invalid due to untimely notice.³⁷²

C. HOMESTEAD EXEMPTION

In *Kendall Builders, Inc. v. Chesson*, the Austin Court of Appeals affirmed the trial court’s ruling that the contractor’s liens were invalid because the property on which the contractor claimed the liens was the appellee’s homestead under the Texas Constitution.³⁷³ In particular, the court held that a family need not occupy the property claimed as its

364. *Id.*

365. *Id.*

366. 150 S.W.3d 553, 562 (Tex. App.—Austin 2004, no pet.).

367. *Id.* at 556.

368. *Id.*

369. *Id.* at 558.

370. *Id.*

371. *Id.* at 558-60.

372. *Id.* at 561.

373. 149 S.W.3d 796 (Tex. App.—Austin 2004, pet. denied); see TEX. CONST. art. XVI, § 50.

homestead, so long as there is sufficient evidence of "a total abandonment of a [prior] homestead with an intention not to return and claim the exemption."³⁷⁴ Jane Chesson and her husband, Phillip Cullen, were relocating to Austin from California and had purchased a home in Austin that required extensive remodeling and refurbishing before it could be occupied. They contracted with Kendall to provide remodeling services and materials. Cullen, who had been transferred to Austin by his employer, moved to Austin, and Chesson stayed in California with the family's children awaiting completion of the remodeling. The family became dissatisfied with Kendall's performance and terminated the contract, whereupon Kendall placed a lien on the property pursuant to Texas Property Code section 53.254.³⁷⁵

If the property was the family's homestead, then Kendall's perfection procedures were inadequate to attach its lien on the property.³⁷⁶ Abandonment is a question of fact, which the trial court answered by finding that the family had abandoned its California home for the Austin property.³⁷⁷ The court of appeals noted that moving from one state to another constitutes evidence of abandonment, especially when a new home is "acquired or used with the intention of making it a homestead."³⁷⁸ The court further noted that in the present case, Cullen had moved out of the California home, and the adult family members had registered to vote (and did in fact vote) in Texas, transferred their driver's licenses to Texas, relocated and registered their car in Texas, and opened a joint-checking account in Austin.³⁷⁹ This evidence, said the court, was legally and factually sufficient to support the trial court's finding that the family had abandoned their California home.³⁸⁰

The court then went on to determine if there was sufficient evidence to support the trial court's finding that the Austin home was the family's homestead at the time it contracted with Kendall.³⁸¹ The family was not occupying the house at the time, so in order to establish the house as the family's homestead, it was necessary to provide evidence showing "an existing bona fide intention to dedicate the property as a homestead" and "acts of preparation and such prompt subsequent occupation as will amount to notice of the dedication."³⁸² The court recounted the evidence of the family's intention to live in Austin and noted that, before engaging Kendall, the family hired an interior decorator.³⁸³ Moreover, the court found that Kendall had actual notice that the family intended to make the

374. *Kendall*, 149 S.W.3d at 808.

375. *Id.* at 800-01.

376. *Id.* at 807. In particular, only one of the spouses signed the contract that was the basis for the lien rather than both, as required by TEX. PROP. CODE ANN. § 53.154. *Id.*

377. *Id.* at 808.

378. *Id.* at 808-09.

379. *Id.* at 809.

380. *Id.*

381. *Id.*

382. *Id.*

383. *Id.*

Austin property its homestead.³⁸⁴ Under these facts, the court had no trouble affirming the trial court's factual findings and judgment invalidating Kendall's liens.³⁸⁵

D. PLACEMENT AGENCY ENTITLED TO LIEN

In *Advance'd Temporaries, Inc. v. Reliance Surety Co.*, the Corpus Christi Court of Appeals found that, under certain circumstances, a labor-placement agency is a "person" entitled to a mechanic's lien under Texas Property Code Chapter 53.³⁸⁶ The trial court found against Advance'd, the temporary agency, but the court of appeals reversed and found that, under the particular facts of the case, Advance'd had "furnished" labor and therefore was entitled to a lien under Texas Property Code section 53.021.³⁸⁷

The court was careful to note that not all temporary employment arrangements will establish that the firm "furnished" labor; it is a question of fact based on "the nature of the arrangement among Advance'd, the temporary workers it supplied, and Gonzalez (the general contractor)."³⁸⁸ There are seven factors that the court identified when considering whether labor has been furnished:

- (1) the temporary employment agency's involvement in selecting and screening the workers for hire;
- (2) the use by the agency of its own criteria for hiring the workers;
- (3) affirmative representations by the agency to the workers that it is their employer;
- (4) the nature of documentation exchanged between the workers and the agency at the start of the working relationship;
- (5) the agency's involvement in training, supervising, and disciplining the workers and otherwise retaining control over the workers or directing their behavior;
- (6) whether the agency rather than the contractor determined which workers could be terminated; and
- (7) whether the agency withheld workers rather than services on nonpayment by the contractor.³⁸⁹

Reliance argued that Advance'd had only provided administrative services, and the trial court agreed, finding that Advance'd merely provided the contractor with recruiting, payroll, and worker's-compensation-insurance services.³⁹⁰ The court of appeals disagreed, noting that the record indicated that Advance'd recruited and hired all workers as its own employees, qualified the workers by verifying legal documentation, issued paychecks to the workers, and made all applicable payroll deductions.³⁹¹ The court also noted that the record showed that the contractor never

384. *Id.* at 810.

385. *Id.* at 811.

386. 165 S.W.3d 1, 2 (Tex. App.—Corpus Christi 2004, pet. granted).

387. *Id.* at 6. "A person has a lien if the person . . . furnishes the labor or materials under or by virtue of a contract with the owner or the owner's agent, trustee, receiver, contractor, or subcontractor." TEX. PROP. CODE ANN. § 53.021(a)(2) (Vernon 2005).

388. *Advance'd*, 165 S.W.3d at 5.

389. *Id.* at 5-6.

390. *Id.* at 6.

391. *Id.*

undertook any screening or hiring qualification decisions.³⁹² Based on the record, the court found that the trial court's findings were clearly erroneous.³⁹³

E. FRAUDULENT LIENS

In *Centurion Planning Corp., Inc. v. Seabrook Venture II*, the Houston Court of Appeals found that the trial court did not err in submitting to the jury Seabrook's claim for violation of the fraudulent lien statute, Texas Civil Practice and Remedies Code section 12.001.³⁹⁴ Seabrook contracted with Centurion to provide engineering services to develop a residential plat in Seabrook, Texas. There was no written agreement, but the oral agreement specified that the plat had to meet all of the city's conditions and ordinances. When Centurion presented the plat to the city, several problems were discovered. Seabrook requested that Centurion make the necessary changes, but Centurion refused. Subsequently, Seabrook cancelled the contract and refused to pay. Centurion filed a lien notice for \$39,416.30.³⁹⁵ Seabrook then filed a declaratory-judgment action, arguing that the lien was null and void under Texas Property Code section 53.021(c) and that Centurion, therefore, presented a fraudulent lien in violation of Texas Civil Practice & Remedies Code section 12.002.³⁹⁶ The jury found that Centurion had no valid lien rights and had presented a fraudulent lien.³⁹⁷

Texas Property Code section 53.021(c) gives an engineer with a *written* contract a lien on the subject property.³⁹⁸ In this case, it was uncontested that the parties had no written contract. Because there was no written contract, Centurion could not have had a valid lien on the property.³⁹⁹ An engineer who attempts to fix a lien on property that is not the subject of a valid contract for engineering services and an engineer who attempts to fix a lien on property in the absence of a valid written contract for engineering services violates Texas Civil Practice & Remedies Code section 53.021(c).⁴⁰⁰

Section 12.002(a) of the Texas Civil Practice and Remedies Code makes it a violation for anyone to make, present, or use a document that the person knows is a fraudulent lien or claim against real property.⁴⁰¹ Centurion argued that this provision did not apply because it was enacted in response to an anti-government group called the Republic of Texas who filed fraudulent court documents.⁴⁰² But the court of appeals dis-

392. *Id.*

393. *Id.*

394. 176 S.W.3d 498 (Tex. App.—Houston [1st Dist.] 2004, no pet.).

395. *Id.* at 502-03.

396. *Id.* at 503.

397. *Id.*

398. *Id.* at 504.

399. *Id.*

400. *See id.*

401. *Id.* at 504-05.

402. *Id.* at 504.

agreed, finding that rules of statutory construction instructed that the statute's plain and common meaning controlled.⁴⁰³ Therefore, it was not error for the trial court to allow the question of whether the engineer had violated section 12.002 to go to the jury.⁴⁰⁴ The fact that section 12.002 was enacted in response to an anti-government group that had made fraudulent court filings and fake documents did not change the plain language of the statute. The legislature could have chosen to limit the statute's application but did not.⁴⁰⁵

F. ASSIGNMENT OF LIEN

A general contractor assigned a lender both a lien created by contract and a Texas Property Code lien in *MG Building Materials, Ltd. v. Moses Lopez Custom Homes, Inc.*⁴⁰⁶ In this case, the Gonzales family contracted with Lopez Custom Homes for construction of their new home and gave it a mechanic's-lien contract to secure payment on a note. Lopez, in turn, assigned to MG "all of Contractor's rights, privileges and equities under any by virtue of the indebtedness, lien and Mechanic's Lien Contract."⁴⁰⁷ Lopez began construction in December 2001 and made six draw requests through February 2003. Lopez made its seventh and final draw request in March 2003 for \$17,044.51, which was approximately \$12,000 more than remained on the Gonzales note. MG, the note holder, issued a check for \$4,683.87 to Lopez, but held the amount in escrow pending the Gonzales's obtaining permanent financing to close on the home. Due to a pending divorce, the Gonzales's never obtained that financing, resulting in MG foreclosing on the note.⁴⁰⁸

Before foreclosure, Lopez filed a claim for a mechanic's lien on the \$17,044.51 and filed suit to foreclose on the lien. The trial court entered a partial summary judgment in favor of Lopez on the foreclosure.⁴⁰⁹ MG challenged the judgment, claiming that the trial court erred in interpreting the lien assignment as applying only to the mechanic's-lien contract between Lopez and Gonzales.⁴¹⁰ The court of appeals agreed with MG, finding that the proper interpretation of the lien assignment was that it applied to both the mechanic's-lien contract and to the statutory lien under Texas Property Code section 53.021(a)(2).⁴¹¹ Specifically, the court found that the new-home contract and mechanic's-lien contract should be read together because they comprised a single agreement; therefore, Lopez "intended to assign to MG whatever right it might have to assert a future lien claim associated with the construction of the Gon-

403. *Id.*

404. *Id.* at 505-06.

405. *Id.* at 505.

406. 179 S.W.3d 51, 59 (Tex. App.—San Antonio 2005, pet. denied).

407. *Id.* at 55.

408. *Id.* at 55-56.

409. *Id.* at 56.

410. *Id.*

411. *Id.* at 59.

zales home, whether by virtue of the new home contract or the mechanic's lien contract."⁴¹² The court reversed the trial court's summary judgment that foreclosed on Lopez's \$17,044.51 mechanic's and materialman's lien.⁴¹³

G. STATUTE OF LIMITATIONS ON LIEN RIGHTS

The interplay of several Texas Property Code sections was at issue in determining whether the statute of limitations had run on a subcontractor's lien claim in *San Antonio Masonry & Tool Supply, Inc. v. Epstein & Sons International, Inc.*⁴¹⁴ The trial court found that Masonry's lien was barred by limitations, but the court of appeals reversed, finding that suit on the claim was filed within the statutory time period specified under Texas Property Code section 53.175(a).⁴¹⁵ That section provides that suit must be filed within either one year after claim notice is served or after the date on which the underlying lien claim becomes unenforceable by statute.⁴¹⁶ Texas Property Code section 53.158 invalidates lien claims made more than two years after the last day a claimant may file a lien affidavit.⁴¹⁷ The parties agreed that Masonry had until April 15, 2001 to file its lien affidavit.⁴¹⁸ Therefore, by statute, Masonry had until April 15, 2003 to file suit to foreclose on the lien.⁴¹⁹ Because it filed suit on April 14, 2003, its claim was not barred by limitations.⁴²⁰

Likewise, the general contractor filed an indemnity bond once Masonry filed its recorded mechanic's lien.⁴²¹ The trial court granted summary judgment in favor of the general contractor, again on limitations.⁴²² Citing the same Texas Property Code provisions, the court of appeals reversed the trial court's judgment.⁴²³

VII. CONSTRUCTION DISPUTES

In the context of general construction disputes, the Texas courts issued opinions concerning evidence in construction litigation, substantial performance in a construction dispute, and conditional-payment clauses.

412. *Id.*

413. *Id.* at 60.

414. No. 04-04-00032-CV, 2005 Tex. App. LEXIS 1089, at *1 (Tex. App.—San Antonio Feb. 9, 2005), *remanded*, No. 04-04-00032-CV, 2005 Tex. App. LEXIS 4757 (Tex. App.—San Antonio June 22, 2005).

415. *San Antonio Masonry*, 2005 Tex. App. LEXIS 1089, at *6-7.

416. *Id.*

417. *Id.* at *5.

418. *Id.*

419. *Id.* at *6.

420. *Id.* at *5-6.

421. *Id.* at *6.

422. *Id.* at *3.

423. *Id.* at *9.

A. CONTRACT AND TORT CLAIMS

In *Barnett v. Coppell North Texas Court, Ltd.*, the Dallas Court of Appeals considered several contract and tort theories on Barnett's appeal of an adverse judgment.⁴²⁴ Barnett's construction company contracted with Coppell to build a new gymnastics facility, but stopped construction before the project was completed. The bank foreclosed on the property and sued both Barnett and Coppell. Coppell cross-claimed against Barnett for breach of contract and received a jury verdict in its favor.⁴²⁵ Barnett appealed the judgment, arguing that his claims for unjust enrichment, negligent misrepresentation, fraud, DTPA violations, and breach of warranty were all established as a matter of law.⁴²⁶

As to the breach-of-contract claim, the jury found that both Barnett and Coppell failed to perform under the contract, but that Barnett's failure excused Coppell's failure.⁴²⁷ The court found some evidence to support the jury's judgment, specifically that Barnett delayed performance, made mistakes as to the placement of structural piers, and walked off the job in the summer of 1999.⁴²⁸ Further, Barnett waived his argument that Coppell waived Barnett's breach, because he failed to plead the defense or to request the related jury questions.⁴²⁹

On his unjust enrichment claim, the court found that unjust enrichment itself is not a claim upon which relief can be granted, but is instead a part of a claim for restitution or *quantum meruit*.⁴³⁰ But even assuming that Barnett had pleaded correctly, his claims failed because the only evidence he offered to show that he provided a benefit to Coppell was draw requests submitted to the bank.⁴³¹ Such requests, which did not contain copies of invoices or bills, did not establish that any services at all were provided.⁴³² A draw request, by itself, is no evidence that a subcontractor furnished "valuable services and/or materials."⁴³³

The court found that Barnett failed to establish, as a matter of law, that Coppell negligently misrepresented the project's lending status.⁴³⁴ The most that Barnett showed was that there was a possibility that the bank made a misrepresentation, not that Coppell had.⁴³⁵ Instead, the court affirmed judgment for Coppell on its misrepresentation claim, noting that in testimony, Barnett represented that he would finish the project on time, had enough workers, and would do "great quality work."⁴³⁶

424. 123 S.W.3d 804 (Tex. App.—Dallas 2003, pet. denied).

425. *Id.* at 812.

426. *Id.*

427. *Id.* at 815.

428. *Id.* at 815-16.

429. *Id.* at 816.

430. *Id.* at 816-17.

431. *Id.* at 817.

432. *Id.*

433. *Id.*

434. *Id.* at 819.

435. *Id.*

436. *Id.* at 820.

In a hollow victory for Barnett, the court found that the trial judge's submission of Coppell's fraud claim was erroneous.⁴³⁷ Unfortunately for Barnett, he failed to object to the trial court's submission of a compound question concerning damages for fraud, breach of warranty, or violations of the DTPA.⁴³⁸ In addition, the court found the evidence sufficient to support the jury's findings of breach of warranty and DTPA violations against Barnett. Thus, any error was harmless.⁴³⁹

The evidence of DTPA violations consisted of Coppell's reliance on Barnett for project management, Coppell's relative inexperience bidding construction projects, Barnett's guarantee that the project would be finished, and his representation that he had adequate workers and "time to spare."⁴⁴⁰ Coppell presented evidence that, without these representations, it would not have hired Barnett. This constituted sufficient evidence that "Barnett engaged in a false, misleading, or deceptive act or practice that appellees relied on to their detriment."⁴⁴¹

Finally, on Coppell's breach-of-warranty claim, Barnett argued that the evidence was legally and factually insufficient to support the jury's findings.⁴⁴² However, the court found that the record showed that Barnett failed to complete his work and that Texas courts hold that such failure is a breach of the warranty of good and workmanlike manner.⁴⁴³ The subsequent property owner also testified that a lot of work remained to be done on the property and that the existing work had to be redone. Taken together, this evidence was sufficient to uphold the jury's finding.⁴⁴⁴

B. SUBSTANTIAL PERFORMANCE AND GOVERNING AGREEMENT

When a subcontract provides that payment is dependent on the architect's final approval and that approval is not given, the subcontractor does not have a right to summary judgment on its breach-of-contract claim against the general contractor according to the Houston Court of Appeals in *Tribble & Stephens Co. v. RGM Constructors, L.P.*⁴⁴⁵ After performance problems related to the concrete resulted in the architect's disapproval, Tribble hired a third party to fix and finish RGM's concrete work. RGM filed suit against Tribble for the contract's unpaid balance, arguing that its work conformed to the contract.⁴⁴⁶ The trial court agreed with RGM, granted summary judgment in its favor, and denied Tribble's motion for summary judgment.⁴⁴⁷

437. *Id.*

438. *Id.* at 820-21.

439. *Id.* at 821.

440. *Id.* at 822.

441. *Id.* at 823.

442. *Id.*

443. *Id.*

444. *Id.* at 823-24.

445. 154 S.W.3d 639, 653 (Tex. App.—Houston [14th Dist.] 2004, pet. denied).

446. *Id.* at 648.

447. *Id.*

On appeal, Tribble argued that the trial court erred in granting RGM's summary-judgment motion because there were material fact issues concerning RGM's performance under the contract.⁴⁴⁸ Specifically, Tribble argued that the construction standards and tolerances incorporated into the general contract were applicable to RGM under the subcontract.⁴⁴⁹ The court of appeals agreed, interpreting the subcontract to incorporate the general contract's standards.⁴⁵⁰ In addition, because the subcontract contained a satisfaction clause giving the architect final-approval authority, the architect's rejection of RGM's work bound the court to determine that RGM was not entitled to summary judgment.⁴⁵¹ The court further noted that "when a contract requires performance to the satisfaction of an architect or engineer, the expert testimony of that architect or engineer may be admissible to determine if the required work was reasonably within the scope of the contract."⁴⁵²

C. CONDITIONAL PAYMENT CLAUSES

The Amarillo Court of Appeals addressed conditional-payment clauses in retainage in *Pyramid Constructors, L.L.P. v. Sunbelt Controls, Inc.*⁴⁵³ Pyramid Constructors entered into a construction contract with Port Neches-Groves Independent School District to construct additional school structures and improvements. Pyramid hired Sunbelt to install heating and air-conditioning equipment. The subcontract allowed Pyramid to withhold retainage from each payment. Sunbelt completed its work in January 2000 and sent a final bill for retainage. Pyramid completed its work in May 2000 and submitted an invoice for retainage on the entire project. Because of a dispute with the owner, "the school district refused to release a portion of the retainage." Pyramid also withheld a portion of the retainage due to the subcontractors. Sunbelt filed suit against Pyramid to recover the balance due.⁴⁵⁴ The trial court granted summary judgment in favor of Sunbelt and against Pyramid to pay retainage, plus interest and attorney's fees.⁴⁵⁵

Pyramid's first argument on appeal was that Sunbelt assumed the risk that the district would not pay Pyramid; therefore, Pyramid was not required to pay its subcontractor until it received payment from the district.⁴⁵⁶ The agreement at issue provided that "[a]ll payments to Subcontractor shall be made by Pyramid solely out of funds actually received by Pyramid from Owner" and noted that Sunbelt was sharing the

448. *Id.* at 650.

449. *Id.*

450. *Id.* at 651.

451. *Id.* at 654.

452. *Id.* at 655.

453. No. 07-03-0443-CV, 2005 Tex. App. LEXIS 1568, at *2-3 (Tex. App.—Amarillo Feb. 28, 2005, no pet.).

454. *Id.*

455. *Id.*

456. *Id.* at *4.

risk that the owner may fail to make payments.⁴⁵⁷ The contract also provided an exception for the clause, that if the owner failed to pay Pyramid because of default solely attributable to Pyramid, the payment would be due from Pyramid to the subcontractor.⁴⁵⁸ Pyramid argued that the “pay when paid” language shifted the non-payment burden to Sunbelt.⁴⁵⁹ Sunbelt argued that the language was not a condition precedent, but a timing provision.⁴⁶⁰

The court declined to opine on whether the language was a condition precedent or a covenant, and instead it focused on the exception to the language.⁴⁶¹ It concluded that the reason for the owner’s non-payment of retainage was solely attributable to Pyramid, and that Pyramid had a duty to pay Sunbelt.⁴⁶² The court also concluded that it was not Sunbelt’s burden of proof to establish that Pyramid was in default of its contract with the district in order to recover.⁴⁶³ The contract language stated the exception in terms of failure to pay Pyramid “on account of default solely attributable to Pyramid,” but did not require that there be an actual default by Pyramid.⁴⁶⁴

VIII. BREACH & WAIVER OF WARRANTY

In *Richardson v. Duperier*, the Houston Court of Appeals held that an express warranty against failure due to defective workmanship or materials superseded the implied warranty of good and workmanlike construction.⁴⁶⁵ In so holding, the court followed *Centex Homes v. Buecher* in which the Texas Supreme Court called the implied warranty of good and workmanlike manner a “gap filler” that applied unless and until the parties to a construction contract “provided for the manner, performance or quality of the desired construction.”⁴⁶⁶ The implied warranty cannot simply be disclaimed, but an express contract clause can supersede the need for it.⁴⁶⁷ The contract at issue provided that Duperier “warrants its products against failure due to defective workmanship or materials for a period of one year from completion date.”⁴⁶⁸ Richardson filed suit after the one-year warranty term, so Duperier was entitled to summary judgment on Richardson’s breach-of-warranty claim.⁴⁶⁹

457. *Id.* at *5-6.

458. *Id.* at *6.

459. *Id.*

460. *Id.*

461. *Id.* at *6-7.

462. *Id.* at *8.

463. *Id.* at *9.

464. *Id.* at *8.

465. No. 14-04-00388-CV, 2005 Tex. App. LEXIS 2746, at *2 (Tex. App.—Houston [14th Dist.] Apr. 12, 2005, no pet. h.).

466. *Id.* at *9-10 (citing *Centex Homes v. Buecher*, 95 S.W.3d 266, 273-75 (Tex. 2002)).

467. *Id.*

468. *Id.* at *9.

469. *Id.* at *12.

The implied warranty of habitability applies only to present defects that make the property “unsuitable for its intended use as a home and unfit for human habitation.”⁴⁷⁰ In *Todd v. Perry Homes*, the Todds, subsequent purchasers of a house that Perry Homes built, challenged Perry Homes’ no-evidence summary judgment that the trial court granted, on the ground that they presented evidence that drainage problems created a risk of mold, rot, or termites.⁴⁷¹ Finding that the implied warranty of habitability applies only to the home’s current condition, the court of appeals affirmed the trial court’s judgment that evidence of future habitability issues is not evidence of breach of the implied warranty of habitability.⁴⁷²

IX. CONSTRUCTION DEFECTS AND INSURANCE COVERAGE

In the context of a commercial-liability policy, Texas courts continue to discuss the question of whether an alleged construction defect can ever qualify as an “occurrence” and trigger an insurer’s duty to defend or to indemnify in favor of an insured contractor. The 2004 and 2005 decisions, especially compared with those in earlier years, make it clear that this question will be determined on a case-by-case basis and may be dependent upon a particular court’s views about the allegations presented. While the decisions have indicated that state courts are reluctant to expand coverage to include damages for the insured contractor’s defective work, there continues to be emphasis on analyzing the definition of “occurrence” and the meaning of “property damage.”

A. “OCCURRENCE”

In *Gehan Homes, Ltd. v. Employers Mutual Casualty Co.*, the Dallas Court of Appeals concluded that Gehan Homes raised a fact issue as to whether it was owed a duty to defend a suit brought by owners of a home built by Gehan.⁴⁷³ Both in their summary-judgment motions and on appeal, the insurers argued that, under the policies, the case did not allege an “occurrence” that would trigger the duty to defend.⁴⁷⁴ In reversing the trial court, the court of appeals determined that, in reviewing a duty to defend, the court was bound to construe the underlying pleadings liberally in favor of the insured.⁴⁷⁵ In addition, Texas law indicated that a negligent breach of a construction contract resulting in defect damages constitutes an occurrence “because the relevant inquiry is not whether the insured damaged his own work, but whether the resulting damage

470. *Todd v. Perry Homes*, 156 S.W.3d 919, 921 (Tex. App.—Dallas 2005, no pet. h.).

471. *Id.* at 921.

472. *Id.*

473. 146 S.W.3d 833, 843 (Tex. App.—Dallas 2004, pet. filed).

474. *Id.* at 837.

475. *Id.* at 838.

was unexpected and unintended.”⁴⁷⁶ Because the pleadings alleged negligence on builder’s the part, the court found that an occurrence triggering the insurers’ duty to defend was alleged in the underlying suit, and reversed the trial court.⁴⁷⁷

On similar grounds, the court reversed the insurers’ summary judgment on the issues of whether “property damage” and “bodily injury,” as defined by the insurance contract, had been sufficiently alleged in the underlying suit in order to trigger the duty to defend.⁴⁷⁸ Again, the insurers argued that the property-damage claim was essentially a contract claim, but the court determined that it would not disregard the claims as provided in the underlying petition.⁴⁷⁹ The owners sought damages for “loss of use” and physical injury to tangible property.⁴⁸⁰ These allegations, said the court, were for damages related to property damage covered by the liability policies.⁴⁸¹ The owners also sought damages for physical injuries and mental pain. These claims, argued the insurers, were not covered by the policy because they were essentially damage allegations for mental anguish.⁴⁸² Even though the owners pleaded these damages under the general heading “Mental Anguish,” the court was bound to construe the pleadings liberally in favor of the insured, and it found that the owners properly alleged bodily injury.⁴⁸³

B. NO DUTY TO DEFEND OR INDEMNIFY FOR EXCLUDED CONSTRUCTION DEFECTS

In a similar declaratory-judgment suit, *Primary Plumbing Services, Inc. v. Certain Underwriters at Lloyd’s London*, the Houston Court of Appeals for the First District determined that the insurer had no duty to defend or indemnify Primary Plumbing Services in an underlying suit where the insurance policy expressly excluded coverage for claims involving construction defects.⁴⁸⁴ In the underlying suit, the plaintiff was injured when a wall-hung lavatory fell on her. The plaintiff alleged,

[Primary], in the course of its plumbing duties was to install a wall hung lavatory on the premises. [Primary] did not install the wall hung lavatory properly and as a result [the plaintiff] was injured. This failure to follow proper plumbing practices in installing the lavatory constitutes negligence.⁴⁸⁵

Lloyds argued that an “accident” creating an “occurrence” under the pol-

476. *Id.* at 843.

477. *Id.* at 846.

478. *Id.*

479. *Id.* at 844.

480. *Id.*

481. *Id.*

482. *Id.*

483. *Id.*

484. No. 01-05-00135-CV, 2005 Tex. App. LEXIS 9622, at *13-14 (Tex. App.—Houston [14th Dist.] Nov. 17, 2005), *withdrawn*, No. 01-05-00135-CV, 2006 Tex. App. LEXIS 718 (Tex. App.—Houston [1st Dist.] Jan. 26, 2006).

485. *Id.* at *3.

icy was not alleged and that it was entitled to summary judgment.⁴⁸⁶ The court of appeals agreed, finding that the underlying petition did not allege facts within the policy's scope.⁴⁸⁷ Specifically, the court found that the insurance policy excluded coverage for claims "involving construction defect(s)," and that the policy's exclusion was not limited to certain types of claims or damages.⁴⁸⁸ Because the policy did not define "construction defect," the court looked to the dictionary definition of "construct" and concluded that the factual allegations in the underlying petition "essentially alleg[ed] that [Primary] negligently constructed, built, or assembled the lavatory in question."⁴⁸⁹ Because the policy excluded any claims "involving" construction defects, it excluded the plaintiff's claims in the underlying suit.⁴⁹⁰ The court rejected, as a matter of law, Lloyd's duty to indemnify Primary for the same reason.⁴⁹¹

C. COVERAGE—PROPERTY DAMAGES

In *Lennar Corp. v. Great American Insurance Co.*, the Houston Court of Appeals determined whether Lennar's costs to remove a defectively designed synthetic stucco from approximately 400 homes constituted "property damage" under its liability insurance policies.⁴⁹² After the stucco's defective nature was discovered, Lennar filed a declaratory-judgment action to determine coverage and indemnity obligations under several liability policies.⁴⁹³ The trial court denied Lennar's summary-judgment motion and granted summary judgment in favor of each insurance carrier on coverage issues.⁴⁹⁴ The court of appeals affirmed Lennar's denied motion for summary judgment and the coverage issues related to the removal, but reversed the trial court on the indemnity issue for water damage repair costs.⁴⁹⁵

On appeal, Lennar argued that the trial court erred in finding that the policies at issue did not cover the costs associated with removing the stucco. Specifically, Lennar argued that because the stucco was causing or could potentially cause rot, termites, and mold, his removal costs were "property damage" caused by an "occurrence" under the policies. The insurance companies disputed that there was "property damage" or an "occurrence." To determine whether summary judgment was warranted, the court engaged in contract interpretation.⁴⁹⁶

486. *Id.* at *4.

487. *Id.* at *10.

488. *Id.*

489. *Id.* at *11.

490. *Id.* at *13-14.

491. *Id.* at *16

492. No. 14-02-00860-CV, 2005 Tex. App. LEXIS 4214, at *3-5 (Tex. App.—Houston [14th Dist.] June 2, 2005), *withdrawn*, No. 14-02-00560-CV, 2006 Tex. App. LEXIS 1457 (Tex. App.—Houston [14th Dist.] Feb. 23, 2006).

493. *Id.* at *5.

494. *Id.* at *1-2.

495. *Id.* at *3.

496. *Id.* at *10.

“Occurrence” under the policies was defined as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.”⁴⁹⁷ Under Texas law, damages caused by the insured’s negligent acts that are undersigned and unexpected are considered occurrences. If an intentionally performed act causes harm because of negligent performance, this is also an accident under Texas law.⁴⁹⁸ The carriers argued that, as a matter of law, defective construction cannot constitute an occurrence because the damage is to the insured’s own work. The court of appeals disagreed and held that Lennar did establish that there was an occurrence.⁴⁹⁹ The court noted that while Texas law is “unsettled” on the issue, defective construction is an occurrence so long as “the resulting damage was unintended and unexpected.”⁵⁰⁰ From Lennar’s standpoint, any damage resulting from the stucco’s application was unexpected and unintended, and thus constituted an occurrence.⁵⁰¹ Even though Lennar chose the defectively designed stucco product,

the subcontractor exception is quite broad. Its application is not limited to situations where the subcontractor’s fault caused the damage. Instead, it merely applies if the damaged work or the work out of which the damage arises was performed on Lennar’s behalf by a subcontractor.⁵⁰²

The carriers fared better on the issue of whether stucco’s removal costs constituted “property damage” under the policies. Here the court found, as a matter of law, that those costs were not “damages because of property damage.”⁵⁰³ The policies defined property damage as “physical injury to tangible property, including all resulting loss of use of that property.”⁵⁰⁴ The court distinguished between three different categories of damages: costs to repair water damage, including the costs to remediate any rot, mold, or termites resulting from the stucco; costs to remove it; and overhead costs, inspection costs, etc.⁵⁰⁵ Of these categories, the policy defined only the first as property damage.⁵⁰⁶ These damages were susceptible to coverage under the policies.⁵⁰⁷ But the policies did not cover Lennar’s costs to remove it because, under the summary-judgment evidence, the court could not conclude that the stucco had to be replaced in order to repair water damage.⁵⁰⁸ “Therefore, the costs incurred by Lennar to remove and replace the stucco as a preventative measure are

497. *Id.* at *17-18.

498. *Id.* at *18 (citing *Lloyd’s of Tex. v. Main Street Homes, Inc.*, 79 S.W.3d 687, 693 (Tex. App.—Austin 2002, no pet.)).

499. *Id.* at *20.

500. *Id.* at *29.

501. *Id.* at *42.

502. *Id.* at *42 n.27.

503. *Id.* at *48.

504. *Id.* at *43.

505. *Id.* at *43-44.

506. *Id.*

507. *Id.* at *45.

508. *Id.* at *49-53.

not damages because of property damage.”⁵⁰⁹

Likewise, costs associated with overhead, inspections, and personnel were not covered because Lennar was not “legally obligated” to pay these; that is, “[w]hile Lennar may have been legally obligated to pay the third-party EIFS claims by replacing the stucco, making repairs, and/or making cash payments, it was not legally obligated to incur its own overhead costs, inspection costs, personnel costs, and attorneys’ fees in connection with settling the claims.”⁵¹⁰

X. STATUTE OF LIMITATIONS AND REPOSE

In *Brent v. Daneshjou*, the Austin Court of Appeals considered statutes of limitation and repose in the construction and repair of a house that Daneshjou built in 1990.⁵¹¹ Brent purchased the house in 1992 and noticed water leaks soon after. Brent contacted Daneshjou about the leaks, and Daneshjou completed repair efforts in January 1993. Again in 1995, Brent noticed that the water leaks were recurring, and that there were new leaks in other parts of the house. Daneshjou again undertook repair efforts and suggested that Brent replace the roof, which he did. Brent continued to experience problems with the house in the fall of 1998, when the 1992 leak resurfaced. This time Brent did not contact Daneshjou; rather, in December 2001, Brent began extensive mold remediation. Brent sued Daneshjou on November 22, 2002, complaining that the original construction was defective and that Daneshjou’s 1993 and 1995 repairs were insufficient to correct the water-incurSION problems plaguing the house.⁵¹²

Daneshjou filed motions for summary judgment, arguing that the statutes of limitation and repose had expired on all of Brent’s claims and, alternatively, that Brent offered no evidence on his breach of contract, breach of warranty, fraud, and DTPA causes of action. The trial court granted summary judgment in favor of Daneshjou on all claims.⁵¹³ The court of appeals affirmed.⁵¹⁴ The Texas Civil Practice & Remedies Code sections 16.008-.009 created the statute of repose at issue and provides that, absent several exceptions, a homebuilder is free from liability ten years after completing the building for “an action arising out of a defective or unsafe condition of the real property or a deficiency in the construction or repair of the improvement.”⁵¹⁵ Thus, absent tolling, the statute of repose expired in 2000.⁵¹⁶

509. *Id.* at *51-52.

510. *Id.* at *54-55.

511. No. 03-04-00225-CV, 2005 Tex. App. LEXIS 9249 (Tex. App.—Austin Nov. 4, 2005, no pet. h.).

512. *Id.* at *2-4.

513. *Id.* at *1.

514. *Id.*

515. *Id.* at *7-9 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 16.009(a) (Vernon 2005)).

516. *Id.* at *10.

Although there was evidence that Daneshjou “cut corners” during the initial construction of the house, the court found no evidence that Daneshjou did so knowing that the house would thereby be dangerous or deficient.⁵¹⁷ In addition, the court found no evidence that Daneshjou deliberately concealed the construction deficiencies that led to Brent’s leaks and mold problems while Daneshjou was repairing the leaks.⁵¹⁸ Thus, the statute of repose was not tolled on the home’s original construction and all of Brent’s claims concerning the construction were barred.⁵¹⁹

The statute of limitations ran on most of Brent’s other claims against Daneshjou.⁵²⁰ The 1993 repairs were barred because Brent discovered in 1995 that the repairs had been insufficient, more than four years before he filed suit.⁵²¹ Likewise, absent tolling, a four-year statute of limitations expiring in 1999 would bar claims on the 1995 repairs.⁵²² The recurrence of the window “leak in 1998 ended tolling from the discovery rule.”⁵²³ But, because the leak’s rediscovery had been alleged to occur in the fall of 1998, a fact question remained as to whether the leak was rediscovered before or after November 22, 1998.⁵²⁴ Other repairs made in 1995, specifically to the home’s stucco exterior, were not barred because Daneshjou had not conclusively shown that Brent should have discovered that the repairs were insufficient before 2001.⁵²⁵

Unfortunately for Brent, those claims did not survive Daneshjou’s no-evidence motion for summary judgment.⁵²⁶ Daneshjou argued, and the court agreed, that Brent produced no evidence (a) of a repair-services contract between them, (b) of a breach of a warranty under the DTPA, (c) of fraud, and (d) of proximate causation on any of Brent’s other causes of action.⁵²⁷ Also, because Daneshjou undertook the repair services for free, any potential contract failed for consideration.⁵²⁸ Because Brent had not paid for the services, he was not a consumer under the DTPA and, therefore, had no standing to assert DTPA violations.⁵²⁹ The court found no evidence of fraud, which Brent sought to prove by focusing on representations and silence concerning the fact that Daneshjou “cut corners” during the home’s initial construction.⁵³⁰ Finally, the court agreed with Daneshjou that Brent produced no evidence of proximate cause on any alleged negligence or breach of warranty with respect to

517. *Id.* at *18-19.

518. *Id.* at *19-20.

519. *Id.* at *20.

520. *Id.*

521. *Id.*

522. *Id.*

523. *Id.* at *24.

524. *Id.* at *24-25.

525. *Id.*

526. *Id.* at *28-32.

527. *Id.*

528. *Id.* at *28.

529. *Id.* at *29-30.

530. *Id.* at *30.

Daneshjou's repair work.⁵³¹

XI. CONTRACTOR LIABILITY FOR SUBCONTRACTOR'S EMPLOYEES

As discussed in prior articles, during 2001 and 2002, the Texas Supreme Court analyzed in some detail the prerequisites for holding a contractor liable for the negligence of a subcontractor's employees. In *Lee Lewis Construction, Inc. v. Harrison*⁵³² and *Dow Chemical Co. v. Bright*, the court outlined the elements of control that were required in order to find contractor liability for acts of a subcontractor's employees.⁵³³

During 2003, the Austin Court of Appeals applied those principles in *Qwest Communications International, Inc. v. AT&T Corp.*⁵³⁴ This case involved Qwest's construction of nationwide fiber-optic-communications networks in order to compete against AT&T and other companies. In 1996, Qwest was laying fiber-optic cable in highway rights-of-way between Austin, San Antonio, and Houston. AT&T's fiber-optic cables already in existence were also buried in the same rights-of-way. Qwest informed AT&T of its activities, and AT&T had on-site representatives to aid in coordinating efforts and to mark the AT&T cables to prevent their damage.⁵³⁵

In order to conduct the required work, Qwest hired C&S Directional Boring Company, Inc. as a subcontractor, and C&S hired CK Directional Drilling as its subcontractor. On September 16, 1997, Qwest severed one of AT&T's cables. In October and December 1997, CK severed the cable a second and third time. AT&T filed suit against Qwest and C&S, seeking damages and other relief. At trial, the Travis County District Court awarded economic and exemplary damages to AT&T. On appeal, Qwest argued that it should not have been held liable for the acts of C&S and CK.⁵³⁶

At trial, the district court submitted four questions to the jury concerning whether C&S was under Qwest's control and whether CK was under C&S's control during the construction and cuts.⁵³⁷ With respect to the second and third cuts, the questions submitted to the jury included (1) whether C&S was "conducting operations for the benefit of Qwest and subject to the control by Qwest as to the detail of the work" and (2) whether CK was "conducting operations for the benefit of C&S Boring and subject to control by C&S Boring as to the details of its work."⁵³⁸ Qwest made two arguments on appeal: "(1) because AT&T did not re-

531. *Id.* at *32.

532. 70 S.W.3d 778, 783-84 (Tex. 2001).

533. 89 S.W.3d 602, 606-07 (Tex. 2002).

534. 114 S.W.3d 15 (Tex. App.—Austin 2003, pet. granted), *rev'd in part*, 167 S.W.3d 324 (Tex. 2005).

535. *Id.* at 21-23.

536. *Qwest*, 167 S.W.3d at 321-23.

537. *Qwest*, 114 S.W.3d at 34.

538. *Id.*

quest a question as to whether Qwest controlled the details of CK's work and the questions did not submit a respondeat superior theory for CK, AT&T waived the theory as between Qwest and CK; and (2) the evidence as to the contractors' lack of independence was legally and factually insufficient."⁵³⁹

The Austin Court of Appeals noted the general rule that "an employer or owner is not liable for the acts of its independent contractors."⁵⁴⁰ The court specified that "for a general contractor to be liable for its independent contractor's acts, it must have the right to control the [works] means, methods, or details."⁵⁴¹ The court also specified that "the control must relate to the injury the negligence causes, and the contract must grant the contractor at least the power to direct the order in which work is [performed]."⁵⁴²

The court of appeals first concluded that the evidence presented was sufficient to support the judgment of Qwest's liability, finding evidence of both actual control and the contractual right to control.⁵⁴³ The court noted that C&S contractually retained some control over CK's work, and C&S retained the right to control CK's hiring decisions in its contract. CK and C&S shared equipment, and the court noted that there was no practical difference between CK and C&S.⁵⁴⁴ In addition, the court found that Qwest's contract specified that Qwest had the right to direct and control C&S, including details in C&S's work, and that Qwest exercised such control.⁵⁴⁵

The court also rejected Qwest's theory regarding jury questions, holding

that where issues that constitute only a part of a complete and independent ground are omitted and other issues necessarily referable to that ground are submitted and answered, the omitted elements are deemed found in support of the judgment if no objection to the omitted elements is made, and the answers are supported by some evidence.⁵⁴⁶

The court noted that "it was AT&T's burden to obtain an affirmative finding of Qwest's control over CK," but that it was Qwest's burden to object to the omission.⁵⁴⁷ Because Qwest did not object and because "the omitted issue constituted only a part of a complete and independent ground" of recovery, the other evidence at trial supported the finding.⁵⁴⁸ The court affirmed the trial court's judgment, concluding that the evidence supported a finding that Qwest controlled C&S, that C&S con-

539. *Id.*

540. *Id.*

541. *Id.* (citing *Lee Lewis Const., Inc. v. Harrison*, 70 S.W.3d 778, 783 (Tex. 2001)).

542. *Id.*

543. *Id.* at 35.

544. *Id.*

545. *Id.*

546. *Id.* at 35-36 (citing *TEX. R. CIV. P.* 279).

547. *Id.*

548. *Id.*

trolled CK, and that Qwest controlled CK.⁵⁴⁹

In *Qwest International Communications, Inc. v. AT&T Corp.*, the Texas Supreme Court granted certification to answer the question of whether evidence that “a corporation’s policy [promoting] ‘a hurried pace’ that resulted in accidentally cutting a competitor’s fiber-optic cable was legally sufficient to support an award of exemplary damages.”⁵⁵⁰ Finding lack of evidence that those who adopted the policy “knew they posed an extreme degree of risk,” the court reversed the Austin Court of Appeals.⁵⁵¹ Although the policy resulted in Qwest three times cutting AT&T’s fiber-optic cables, the award of exemplary damages could not be sustained.⁵⁵² “What is lacking is clear and convincing evidence that Qwest’s upper management had actual knowledge that a policy to lay cables rapidly posed a degree of risk that was extreme; knowledge of a remote possibility of serious injury or a high probability of minor injury was not enough. . . Nor is there evidence that they proceeded with the construction in conscious disregard of such a risk.”⁵⁵³ Thus, a reasonable jury could not have formed a firm belief that Qwest acted with the malice required to collect exemplary damages.⁵⁵⁴

XII. RESIDENTIAL CONSTRUCTION LIABILITY ACT

In *Bankhead v. Maddox*, the Tyler Court of Appeals said that Bankhead waived her right to appeal a jury award of zero attorneys’ fees in her construction-defect suit against Maddox.⁵⁵⁵ Bankhead’s appeal brief focused on Texas Civil Practice and Remedies Code section 38.001, which mandates attorney’s fees in breach-of-contract actions. However, Maddox argued that Bankhead ignored the Residential Construction Liability Act (“RCLA”),⁵⁵⁶ which applies to house construction.⁵⁵⁷ The court of appeals agreed with Maddox that the RCLA superseded the Civil Practices and Remedies Code to the extent that the two conflicted.⁵⁵⁸ Because the RCLA does not mandate attorney’s fees, the RCLA was the controlling law.⁵⁵⁹ Also, because Bankhead did not raise the RCLA on appeal, she waived the issue, and the trial court’s judgment was affirmed.⁵⁶⁰

549. *Id.* at 46.

550. *Qwest*, 167 S.W.3d at 325.

551. *Id.* at 325-26; *see* TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(11) (Vernon 2003).

552. *Qwest*, 167 S.W.3d at 327.

553. *Id.* at 327.

554. *Id.*

555. 135 S.W.3d 162, 165 (Tex. App.—Tyler 2004, no pet.).

556. *Id.* at 163.

557. *Id.*; TEX. PROP. CODE ANN. § 27.002 (Vernon 2006).

558. *Bankhead*, 135 S.W.3d at 163.

559. *Id.*

560. *Id.* at 164.

XIII. THE SUBSTANTIAL-PERFORMANCE DOCTRINE

The appellate courts addressed two interesting cases on the doctrine of substantial performance and its relationship to a party's ability to sue for breach.

A. FINAL PAYMENT

In *TA Operating Corp. v. Solar Applications Engineering, Inc.*, the San Antonio Court of Appeals was faced with an issue of first impression in Texas: "whether the doctrine of substantial performance excuses a contractor's [non-performance of an] express condition precedent to final payment of a contract."⁵⁶¹ The trial court answered in the affirmative, but the court of appeals disagreed.⁵⁶² In this case, the express condition precedent was an all-bills-paid affidavit, which was intended to foreclose the possibility that TA, the owner, would have to pay twice on truck-stop construction.⁵⁶³

TA did not dispute that Solar had substantially performed under the contract. Instead, it relied on an express condition in the contract that stated: "[t]he final Application for Payment shall be accompanied by: . . . iii) complete and legally effective releases or waivers (satisfactory to OWNER) of all Lien rights arising out of or Liens filed in connection with the Work."⁵⁶⁴ When Solar filed suit for final payment, it had not secured such waivers or releases, and the evidence showed that the property was burdened with liens totaling almost \$250,000.⁵⁶⁵ The court of appeals acknowledged that the substantial-performance doctrine was intended to modify the common-law rule of strict compliance with contract terms,⁵⁶⁶ but held that the substantial-performance doctrine applied only to constructive conditions precedent, not to express conditions precedent. A constructive condition precedent is one that, though not express in a contract, obligates the other party to perform once it is met. The all-bills-paid affidavit, on the other hand, was an express condition precedent written in the contract.⁵⁶⁷ Therefore, the court rendered judgment that Solar take nothing on its breach-of-contract claim.⁵⁶⁸

B. SUBSTANTIAL PERFORMANCE, MATERIAL BREACH, AND EXCUSED PERFORMANCE

In *Hooker v. Nguyen*, the Houston Court of Appeals found that Hooker, a salon developer, was excused from paying Nguyen, the con-

561. No. 04-04-00180-CV, 2005 Tex. App. LEXIS 7908 (Tex. App.—San Antonio Sept. 28, 2005, pet. filed).

562. *Id.* at *1.

563. *Id.* at *15.

564. *Id.* at *4-5.

565. *Id.* at *5.

566. *Id.* at *10-11, *15-16.

567. *Id.* at *14-15.

568. *Id.* at *16.

tractor, because Nguyen failed to substantially perform the contract.⁵⁶⁹ Hooker contracted with Nguyen to provide build-out construction work for a salon. The original contract did not include a completion date.⁵⁷⁰ Hooker became anxious when, in mid-October, he noted that Nguyen was failing to make progress on the build-out. Hooker sent a letter to Nguyen dated November 30, 2000, in which Hooker claimed that the original due date was December 1, the date that Hooker was to begin paying rent on the space.⁵⁷¹ By January 18, 2001, the salon was still incomplete. The parties met and signed a document that listed outstanding tasks to be completed by Nguyen before February 4, 2001. This date passed, and on February 11, 2001, Hooker notified Nguyen that he was terminating their contract. On February 12, 2001, Hooker's lawyer sent Nguyen a letter claiming that he was in substantial breach of the agreement. Hooker refused to pay the contract's \$44,159.20 outstanding balance.⁵⁷²

The jury found for Nguyen on the breach-of-contract issue and said that Hooker was not excused from performing.⁵⁷³ But the jury also found that Nguyen breached the agreement and failed to substantially perform.⁵⁷⁴ Following *Mustang Pipeline Co. v. Driver Pipeline Co.*, the court applied the Restatement (Second) of Contracts section 241, which contains five factors to determine whether a failure to perform is material:

(a) the extent to which the injured party will be deprived of the benefit which he reasonably expected; (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived; (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of the circumstances including any reasonable assurances; (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.⁵⁷⁵

The court also noted that section 242 lists "significant circumstances that aid in a determination of whether a party's duties are discharged under a contract due to the other party's material breach."⁵⁷⁶ Those circumstances are whether the failure to perform causes a delay that prevents the party from making alternative arrangements and whether the contract has a firm due date that, under the circumstances, indicates that the date

569. No. 14-04-00238-CV, 2005 Tex. App. LEXIS 8753, at *32 (Tex. App.—Houston [14th Dist.] Oct. 20, 2005, pet. filed) (mem. op.).

570. *Id.* at *3.

571. *Id.* at *3-4.

572. *Id.* at *5-7.

573. *Id.* at *7.

574. *Id.* at *8.

575. *Id.* at *24-25 (citing RESTATEMENT (SECOND) OF CONTRACTS § 241 (1981)).

576. *Id.* at *25.

is important.⁵⁷⁷ Based on Nguyen's failure to complete the project on time or to cure his failure to perform, his delays that prevented Hooker from making alternative construction arrangements, and the jury's determination that Nguyen failed to substantially perform, the court of appeals found this to be a material breach excusing Hooker's performance under the contract.⁵⁷⁸ Thus, the court reversed judgment against Hooker and rendered judgment that Nguyen take nothing.⁵⁷⁹

XIV. LEGISLATIVE DEVELOPMENTS

During 2005, the legislature made some revisions to the Property Code in regard to mechanic's liens. Most significantly, however, the legislature clarified the scope of immunity from suit for a governmental entity that contracts for services with a private party.

A. THE PROPERTY CODE

Texas Property Code section 53.103 regarding liens on retained funds was revised in 2005, to provide as follows:

A claimant has a lien on the retained funds if the claimant:

- (1) sends the notices required by this chapter in the time and manner required; and
- (2) files an affidavit claiming a lien not later than the 30th day after the earlier of the date:
 - (A) the work is completed;
 - (B) the original contract is terminated; or
 - (C) the original contractor abandons performance under the original contract.⁵⁸⁰

B. SOVEREIGN IMMUNITY IN CONSTRUCTION CONTRACTS

The Texas Legislature adopted legislation in 2005 that made it clear that a public entity that enters into a contract waives immunity from suit with respect to any action relating to the contract.⁵⁸¹ The Government Sovereign Immunity Bill, House Bill 2039, addressed this issue, which is codified in Chapter 271 of the Local Government Code.⁵⁸²

Chapter 271.151 of the new statute contains relevant definitions for the provisions.⁵⁸³ 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

577. *Id.* at *25-26.

578. *Id.* at *26-32.

579. *Id.* at *33.

580. TEX. PROP. CODE ANN. § 53.103 (Vernon Supp. 2005).

581. TEX. LOC. GOV'T CODE ANN. ch. 271 (Vernon 2003).

582. *Id.*

583. *Id.* § 271.151.

purposes of adjudicating a claim for breach of the contract, subject to the terms and conditions of this subchapter.⁵⁸⁴

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

(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.⁵⁸⁵

Section 271.154 provides that the contract's adjudication procedures, including requirements to engage in alternative dispute resolution before suit, are enforceable, except to the extent that they conflict with the statute.⁵⁸⁶ Additional sections provide that there is no waiver of immunity from suit in federal court or for tort liability.⁵⁸⁷ Finally, attorneys' fees that the local governmental entity or any other party incurred in a claim adjudication by or against a governmental entity are not awarded unless a written agreement authorizes it.⁵⁸⁸

584. *Id.* § 271.152.

585. *Id.* § 271.153.

586. *Id.* § 271.154.

587. *Id.* §§ 271.156-.157.

588. *Id.* § 271.159.

