



1994

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Recommended Citation

Robert L. Meyers III, et al., *Construction Law*, 47 SMU L. Rev. 891 (1994)
<https://scholar.smu.edu/smulr/vol47/iss4/8>

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CONSTRUCTION LAW

*Robert L. Meyers, III**
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IN the area of construction law, it was clearly a case of quality as opposed to quantity during the Survey period. The cases which are the subject of this Survey article reflect significant decisions in a number of different areas affecting construction law, including competitive bidding, mechanic's liens, the discovery rule, burden of proof and the DTPA.

I. PUBLIC PROJECTS — MCGREGOR ACT

Claims against an insolvent surety and the municipal owner of the project were at issue in *City of La Porte v. Taylor*.¹ Taylor was a subcontractor on a swimming pool project being constructed pursuant to a contract between the general contractor, Crystal, and the City. Following default by Crystal, Texas Insurance Company, Crystal's surety, took over the project and instructed Taylor to cease work. The surety subsequently became insolvent, leaving the City with an unfinished project and the necessity of spending

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1. 836 S.W.2d 829 (Tex. App.—Houston [1st Dist.] 1992, n.w.h.).

\$45,000 in excess of the original \$372,610 contract. Taylor brought suit to perfect an equitable lien under section 53.231 of the Property Code² and article 5160(A)(b) of the Texas Revised Civil Statutes (McGregor Act).³ The trial court found the City, the surety, and Crystal jointly and severally liable for the amount owed Taylor. The City appealed on the grounds that the City had sovereign immunity and that article 5160 was the claimant's exclusive statutory remedy, barring an implied cause of action or the imposition of an equitable lien against public funds.

The court of appeals agreed and reversed.⁴ Although article 5160 required a surety bond to secure payment in case of a default in a contract involving a municipality, the City could not be held liable when the surety for the payment bond became insolvent.⁵ Therefore, no lien could be created.⁶ The court distinguished this case from three prior similar cases because in those cases, the bonds issued were fraudulent from the beginning because the surety companies were non-existent.⁷ Here, the surety existed when the bonds were issued and subsequently became insolvent.⁸

II. PROJECT COMPLETION

The Corpus Christi Court of Appeals recently decided a case dealing with both mechanic's liens and statutory interpretation. The court interpreted the term "completed" for purposes of section 53.101 of the Property Code⁹ in *TDIndustries, Inc. v. NCNB Texas National Bank*.¹⁰ NCNB contracted with the general contractor for improvements to rental space. The contract required *substantial completion* of finish-out by January 1, 1990. TDI subcontracted to complete the heating and air conditioning systems. Section 53.101 requires that the owner retain ten percent of the balance due for thirty days after *actual completion* of the project.¹¹ On January 1, 1990, NCNB's tenant accepted the premises as complete, and the next day the architect certified that 100 percent of the work had been completed, despite knowledge that a pocket door was missing. This door was finally installed on February 28, 1990. The trial court found that the completion date was January 1, and therefore, TDI's mechanic's lien was invalid because it was untimely filed.

2. TEX. PROP. CODE ANN. § 53.231 (Vernon 1984).

3. TEX. REV. CIV. STAT. ANN. art. 5160(A)(b) (Vernon 1987). The actions which gave rise to this suit occurred before the 1989 amendment to article 5160. Article 5160 was repealed by Acts 1993, 73d Leg., ch. 268, § 46(1), eff. Sept. 1, 1993, and without reference to the repeal was amended by Acts 1993, 73d Leg., ch. 865, § 1, eff. Sept. 1, 1993.

4. *Id.* at 832.

5. *Id.*

6. *Id.*

7. *Id.* at 832. See *Corpus Christi v. Heldenfels Bros.*, 820 S.W.2d 35 (Tex. App.—Corpus Christi 1990), *aff'd*, 832 S.W.2d 39 (Tex. 1992); *Corpus Christi v. Acme Mechanical Contractors*, 736 S.W.2d 894 (Tex. App.—Corpus Christi 1987, writ denied); *Corpus Christi v. S.S. Smith & S. Masonry*, 736 S.W.2d 247 (Tex. App.—Corpus Christi 1987, writ denied).

8. *City of La Porte*, 836 S.W.2d at 832.

9. TEX. PROP. CODE ANN. § 53.101 (Vernon Supp. 1994).

10. 837 S.W.2d 270 (Tex. App.—Eastland 1992, no writ).

11. See *id.* at 272.

Holding that the statute requires *actual* completion of work required under the original contract, including extras or change orders, the court of appeals reversed.¹² Because NCNB had paid some of the required retainage to the general contractor on February 2, NCNB had failed to comply with section 53.101.¹³ Therefore, TDI, the subcontractor, could timely file a lien affidavit under section 53.052.¹⁴

III. MECHANIC'S LIENS

Perfection and notice of mechanic's lien claims were the issues before the Texas Supreme Court in *Valdez v. Diamond Shamrock Refining & Marketing Co.*¹⁵ Valdez was a subcontractor on the project who completed his work and timely filed a mechanic's lien pursuant to Section 53.052 of the Property Code,¹⁶ with proper notice to the developer and owner as of the time of its subcontract. In the interim, Diamond Shamrock purchased 0.8 acres of the original 7.9 acres comprising the project. Both the trial court and the court of appeals found that because Valdez did not give notice to Diamond Shamrock, he had not properly filed his lien.¹⁷

The supreme court reversed, noting that the Property Code allowed the name of the owner or *reputed* owner to be used on a mechanic's lien affidavit.¹⁸ The court then reaffirmed the basic "relation back" doctrine of section 53.124(a) so that the effective date of the lien, once perfected, related back to the earlier of: "(1) the commencement of visible construction or delivery of materials, or (2) the recording of a written agreement or affidavit acknowledging that a contractor or subcontractor has been engaged."¹⁹

IV. RIGHTS OF MATERIAL SUPPLIERS

Not surprisingly, contract interpretation continues to be a source of litigation in the construction area. The controversy in *Staff Industries Inc. v. Hallmark Contracting, Inc.*²⁰ centered around whether a subcontractor was to be paid for materials *supplied* or materials *actually used* at a construction site. The contract provided for payment for an "indeterminate amount of material at a unit price."²¹ Staff, a subcontractor on the project, was to

12. *Id.* at 272; see TEX. PROP. CODE ANN. § 53.106(e) (Vernon Supp. 1994).

13. *TDIndustries*, 837 S.W.2d at 272.

14. *Id.*; see TEX. PROP. CODE ANN. § 53.052 (Vernon Supp. 1994).

15. 842 S.W.2d 273 (Tex. 1992). While *Valdez* involves facts occurring in 1985 and 1986 and therefore invokes the Property Code sections in effect at that time, the particular mechanic's lien provisions at issue in this case were substantially unchanged by the 1989 revisions. *Id.* at 274.

16. TEX. PROP. CODE ANN. § 53.052 (Vernon 1984 & Supp. 1994).

17. *Valdez*, 842 S.W.2d at 274.

18. *Id.* at 276.

19. *Id.* The 1989 revision to § 53.124 deleted the former provision (a)(2) and simply provides that the inception date of the lien is the date when "visible construction or delivery of materials begins." *Id.* at 276 n.4. The former provision (a)(2) is now embodied in the affidavit of commencement described in § 53.124(c). TEX. PROP. CODE ANN. § 53.124(c) (Vernon Supp. 1994).

20. 846 S.W.2d 542 (Tex. App.—Corpus Christi 1993, n.w.h.).

21. *Id.* at 545.

manufacture and install Hypalon to line the project fish ponds. A dispute arose as to the interpretation of the contract regarding the amount Hallmark, the general contractor, owed its subcontractor, Staff, for the Hypalon. Hallmark was willing to pay based on the amount of material *installed*, while Staff asserted it was owed for all of the material *provided*. The trial court ordered each side to take nothing, while rendering a declaratory judgment that Hallmark owed Staff for the material *installed*.

The court of appeals, in reviewing the trial court's decision, discussed principles of contract interpretation.²² Where, as here, the contract is ambiguous, courts interpret the contract based on the intent of the parties, considering the contract language and surrounding circumstances.²³ Included in the surrounding circumstances are the conduct of the parties and industry standards.²⁴

The purchase order at issue provided for payment for furnishing "materials . . . in strict accordance with the contract plans and specifications."²⁵ Hallmark's position was that the purchase order provision implied that Hallmark only owed Staff for the material which actually covered the specified area in the plans. Staff relied on language in the plans and specifications which provided that "payment shall be for the actual . . . material furnished."²⁶ The court of appeals disagreed with Staff's position because the plans and specifications clause was in the contract between Hallmark and the owner, not the contract between Hallmark and Staff.²⁷ While there was conflicting evidence as to the intent of the parties and industry standards, the court of appeals concluded that there was sufficient evidence to support the trial court's construction in favor of Hallmark.²⁸ The court of appeals also held that the declaratory judgment was improper.²⁹ The trial court should have simply entered judgment that Staff take the lesser of the contested amounts as payment for material actually installed.³⁰

V. DEMOLITION

In *J & J Equipment, Inc. v. Pilkinton*³¹ Carter was a general contractor for demolition and waste removal on a project for which Pilkinton was acting as the owner. C.D. Lowe was the subcontractor for demolition work, and J & J supplied demolition equipment to Lowe. When neither the subcontractor nor the general contractor paid J & J for the equipment rental, J & J sued them along with Pilkinton. The trial court entered judgment for the equipment rental amount against Carter, and a take-nothing judgment favoring

22. *See id.* at 545-46.

23. *Id.* at 546.

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.* at 546-47.

28. *Id.* at 547.

29. *Id.* at 548.

30. *Id.*

31. 850 S.W.2d 804 (Tex. App.—Corpus Christi 1993, writ denied).

Pilkinton; Lowe, who had never been served, was dismissed without prejudice.

The court of appeals affirmed, though on a different legal basis.³² Pursuant to section 53.021 of the Property Code, a subcontractor is entitled to a mechanic's or materialman's lien if he "furnishes labor or materials for construction or repair in this state of . . . a house, building, or improvement . . . by virtue of a contract with the owner or the owner's . . . contractor, or subcontractor."³³ This statute does not apply to the *demolition* of a structure, unless the contract provides for the filing of a lien.³⁴ There was no such agreement in this case, and therefore J & J could not look to the owner (Pilkinton) or the project property for recovery.³⁵

VI. BID PROTESTS

The court of appeals decision in *Urban Electrical Services, Inc. v. Brownwood Independent School District*³⁶ rejected claims asserted by the unsuccessful but low bidder on a state public improvements project.³⁷ Urban Electrical was the low bidder for the construction of a baseball field lighting system for the Brownwood Independent School District. Despite Urban Electrical's low bid, the construction contract was awarded to a higher bidder. Urban Electrical then sued the Brownwood Independent School District for breach of contract.

Urban Electrical asserted that submittal of the lowest responsible bid created a contract implied-in-law.³⁸ The court of appeals rejected this claim.³⁹ In so doing, the court reasoned that the school district's advertisement for bids was a solicitation and not an offer to enter into a contract, the offer rather being made by Urban Electrical when it submitted its bid.⁴⁰ Then, the court referred to the language of the Texas Local Government Code which permits the awarding authority to reject any and all bids.⁴¹ The troublesome point — although not to the court of appeals — is that the school district did not reject all bids, but rather awarded the contract to the next lowest bidder and not to Urban Electrical.

The facts of the case show that Urban Electrical was notified of the school district's decision to make the award to the next lowest bidder on January 11, 1988, and that the contract with the next lowest bidder was entered into on January 22, 1988. Urban Electrical filed suit against the school district

32. *Id.* at 806.

33. TEX. PROP. CODE ANN. §§ 53.021(a)(1)(A), (a)(2) (Vernon Supp. 1994).

34. *J & J Equip.*, 850 S.W.2d at 805-06.

35. *Id.* at 806.

36. 852 S.W.2d 676 (Tex. App.—Eastland 1993, n.w.h.).

37. *Id.* at 677.

38. Urban relied upon provisions of the Texas Local Government Code requiring that the award be made to the lowest responsible bidder. TEX. LOC. GOV'T CODE ANN. §§ 271.021-271.027 (Vernon 1988 & Supp. 1994).

39. *Urban Elec.*, 852 S.W.2d. at 677.

40. *Id.* at 677-78.

41. *Id.* at 678. Section 271.027(a) provides: "The governmental entity is entitled to reject any and all bids." TEX. LOC. GOV'T CODE ANN. § 271.027(a) (Vernon 1988).

on August 2, 1988, by which time work under the contract had been completed. The court of appeals held that the appropriate action by Urban Electrical was one for injunctive relief and that Urban Electrical was guilty of laches under the facts; i.e., there was an unreasonable delay by Urban Electrical in asserting legal and equitable rights and there was a good faith change of position by the school district to its detriment due to Urban Electrical's delay.⁴² Arguably, the school district's actions were not in good faith; however, this point was not discussed.

No doubt the court was influenced by Urban Electrical's failure to enjoin the contract prior to its performance. As the court stated,

Allowing Urban to recover lost profits from the school district, as opposed to allowing them to enjoin the letting of the contract to the next lowest bidder, would be contrary to the public interest that the bidding laws were designed to protect. The taxpayers would be penalized twice: once for the overpayment to the company receiving the bid and once for Urban's lost profits.⁴³

Practitioners familiar with the area have long recognized the advisability of injunctive action in these situations; in light of *Urban Electrical Services*, such is not only advisable but possibly the only available recourse.

VII. DISCOVERY RULE

The Corpus Christi Court of Appeals affirmatively held that the discovery rule applies to construction disputes in its opinion in *Dallas Market Center Hotel Co. v. Beran & Shelmire*.⁴⁴ The Dallas Market Center Hotel Company brought suit on theories of negligent design and construction, breach of contract and breach of warranty arising out of water leaks in the Anatole Tower portion of the Anatole Hotel.⁴⁵ Although the Anatole Tower was completed in 1983, suit was not filed until after a March 1990 determination by the owner's structural consultant that design deficiencies existed in the architectural and structural plans and specifications. The action before the trial court resulted in summary judgment in favor of Beran & Shelmire based on the application of the statute of limitations. The court of appeals reversed and remanded.⁴⁶

In reversing, the court noted that the discovery rule provides that a cause of action does not accrue nor does the statute of limitations begin to run until the party either knew or should have known of the facts supporting each element of the cause of action.⁴⁷ In rejecting the argument that the discovery rule is inapplicable to construction cases, the court stated: "[W]e

42. *Urban Elec.*, 852 S.W.2d at 678.

43. *Id.*

44. 865 S.W.2d 145 (Tex. App.—Corpus Christi 1993, writ requested).

45. Dallas Market Center Hotel Company brought the referenced action as owner of the Anatole Tower. This case involves a different owner and claims than presented in *Dallas Market Center Development Co. v. Beran & Shelmire*, 824 S.W.2d 218 (Tex. App.—Dallas 1991, writ denied).

46. *Dallas Mkt. Ctr. Hotel Co.*, 865 S.W.2d at 146.

47. *Id.* at 147 (citing *Burns v. Thomas*, 786 S.W.2d 266, 267 (Tex. 1990)).

find no case law holding that the discovery rule is inapplicable to construction cases grounded upon negligence, breach of warranty, or breach of contract [T]he policy considerations underlying the application of the discovery rule are also present in the construction context."⁴⁸

The court of appeals found the discovery rule applicable in the instant case even though leaks were present and known as early as 1983.⁴⁹ The court found that genuine issues of fact existed as to whether the widespread masonry deterioration which was discovered in 1989 and 1990 and formed the basis of the suit was unrelated to leaks previously discovered in 1985.⁵⁰ Hence, summary judgment on the basis of the statute of limitations was not appropriate.⁵¹ Significantly, Beran & Shelmire acknowledged in a 1990 deposition that earlier leak problems were isolated and that the parties had only become aware of the leakage and masonry deterioration problems at issue within the last year.

Although the case involved the appeal of summary judgment and resulted in remand, the court's intent to clearly establish the applicability of the discovery rule in construction cases is unmistakable: "An aggrieved party frequently does not discover an injury until months or years after construction is completed. Such a situation would lead to a particularly unjust result if limitations barred the action before it was discovered."⁵²

VIII. COMPLETION COSTS

The Texas Supreme Court established a significant distinction between lump sum and cost plus construction contract disputes in *Sage Street Associates v. Northdale Construction Co.*⁵³ This case involved a Department of Housing and Urban Development (HUD) financed apartment project. The parties initially entered into a cost plus fee contract reflecting a fee of \$760,000. The contract provided for a maximum price of \$13,535,000 and provided further that Northdale (the general contractor) would receive profit and overhead totalling \$760,000,⁵⁴ notwithstanding contrary provisions in FHA Form 2442A (the HUD form of cost plus construction contract). After entering into the foregoing contract, the parties executed a second construction contract covering the same work, that contract being the HUD form of construction contract referred to in the initial agreement. The HUD contract between Sage Street and Northdale was also a cost plus contract; however, it provided for payment of costs of construction plus a fee of "\$ NONE"⁵⁵ and that in no event would the total amount payable exceed

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.*

53. 863 S.W.2d 438, 442 (Tex. 1993).

54. This total was to consist of an overhead allowance of \$261,159 and an aggregate of \$498,841 for profit and overhead in subcontracts "with affiliates of the Contractor for concrete and carpentry work." *Id.* at 441.

55. *Id.*

\$13,535,000. Disputes arose during construction, and Northdale stopped work and was terminated prior to completion.

At trial, Northdale recovered the costs of its work together with its overhead and profit. The court of appeals affirmed.⁵⁶ In essence, Northdale was awarded the full unpaid balance of the construction contract, without adjustment for Sage Street's completion costs.⁵⁷

Sage Street contended before the Texas Supreme Court that Northdale had to establish the cost of completion and that in failing to do so Northdale had failed to meet an essential element in its burden of proof on recovery of damages.⁵⁸ The court rejected Sage Street's position, finding such reasoning to be inapplicable to cost plus contracts, and distinguished them from lump sum or fixed price agreements with respect to the burden of proof.⁵⁹ In discussing the nature of cost plus agreements the court stated:

The builder's profit . . . is either a contractually defined percentage of costs or, as in this case, a flat fee added to costs; it is not the difference between costs and a contractually fixed price. Accordingly, the plaintiff's burden in suing on a cost-plus contract is only to prove the contract, the breach, and the total reimbursable costs.⁶⁰

The court concluded that where the owner is responsible for the contractor's incomplete performance under a cost plus contract, the contractor is not responsible for establishing that the work would have been done within a maximum cost, and that the owner's claims for completion costs are in the nature of claimed credits which must be proved by the owner.⁶¹

The court differentiated between lump sum and cost plus contracts, with a resulting shift in the burden of proof as to completion costs.⁶² While this may be appropriate in a pure cost plus fee arrangement, the distinction where the cost plus fee contract is subject to a guaranteed maximum price is somewhat artificial. Arguably the issue in such instances should remain whether or not completion could have been achieved by the contractor within the maximum cost, since to do otherwise permits the contractor to use a form of total cost recovery, at least as to the work it performed. Nevertheless, the court does not distinguish between pure cost plus fee and cost plus fee subject to a guaranteed maximum price contracts in *Sage Street Associates*, but rather treats the two the same and both different from lump sum agreements.

The court also determined that the existence of the two separate construction contracts created an ambiguity as to whether Northdale was owed its

56. *Id.* at 442.

57. *Id.* at 441.

58. Sage Street's position is supported by existing case law. See *Farris v. Smith Erectors, Inc.*, 516 S.W.2d 281, 283-84 (Tex. Civ. App.—Houston [1st Dist.] 1974, no writ) (stating that the burden of proof is on the contractor to provide data from which damages may be computed, including proof of the probable cost to the plaintiff of completing performance).

59. *Sage Street Assocs.*, 863 S.W.2d at 442.

60. *Id.*

61. *Id.* at 443.

62. *Id.* at 442-43.

\$760,000 fee,⁶³ but found that the issue was submitted to the jury by implied consent even though neither party pled the issue.⁶⁴ The court did, however, remand the case to the court of appeals due to the failure of the court of appeals or the trial court to consider the expenses avoided by Northdale by its not completing the work.⁶⁵ Hence, the court recognized Sage Street's right to reduce Northdale's recovery by the amount Northdale was not required to expend.⁶⁶

IX. DTPA-NO PRIVITY REQUIRED

The Dallas Court of Appeals examined the application of the DTPA⁶⁷ in a construction/repair case involving rainwater damage to the property of a leasehold tenant in *D/FW Commercial Roofing Co. v. Mehra*.⁶⁸ The dispute involved damages suffered when the stored inventory of the tenant was subjected to rainwater resulting from the removal of the roof protecting the leased space. The owner of the property had contracted with D/FW Commercial to repair the roof, and during the repairs a portion of the roof was removed. When it rained, the tenant's contents within the leased space suffered water damage. Mehra (the tenant and plaintiff) did not engage D/FW Commercial, nor was Mehra notified of the pending work.

Mehra's DTPA claim was based on D/FW Commercial's breach of its implied warranty to perform in a good and workmanlike manner.⁶⁹ D/FW Commercial appealed the trial court's decision, contending recovery under the DTPA was improper because Mehra was not a consumer, based on (1) the absence of privity between the parties, and (2) Mehra's status as an incidental beneficiary of the transaction. The court of appeals first concluded that Mehra was a consumer under the DTPA.⁷⁰ "The Act does not require the same person to both acquire and purchase the goods. . . . The general rule is that there is no 'privity' requirement under the Act."⁷¹ The court went on to reject D/FW Commercial's argument that section 17.50(a)(2) does require privity, unlike the other provisions of section 17.50(a).⁷² The

63. *Id.* at 445.

64. *Id.*

65. *Id.* at 447.

66. *Id.*

67. TEX. BUS. & COM. CODE ANN. §§ 17.41-17.63 (Vernon 1987 & Supp. 1994).

68. 854 S.W.2d 182 (Tex. App.—Dallas 1993, n.w.h.).

69. See TEX. BUS. & COM. CODE ANN. § 17.50(a)(2) (Vernon 1987).

70. See *D/FW Commercial Roofing*, 854 S.W.2d at 185. The definition of "consumer" under the DTPA is provided in § 17.45(4). TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon 1987).

71. *D/FW Commercial Roofing*, 854 S.W.2d at 185.

72. *Id.* at 186. Section 17.50(a) provides:

(a) A consumer may maintain an action where any of the following constitute a producing cause of actual damages:

- (1) the use or employment by any person of a false, misleading, or deceptive act or practice that is specifically enumerated in a subdivision of Subsection (b) of Section 17.46 of this subchapter;
- (2) breach of an express or implied warranty;
- (3) any unconscionable action or course of action by any person; or
- (4) the use or employment by any person of an act or practice in violation of

basis of the distinction which D/FW sought to draw was that unlike the other producing causes of damage set forth in section 17.50(a), section 17.50(a)(2) — breach of an express or implied warranty — does not include the phrase “any person.”⁷³ D/FW Commercial’s conclusion was that the purposeful omission of this language from section 17.50(a)(2) demonstrated a legislative intent to limit DTPA remedies for breach of warranty to those persons in privity with the party furnishing the warranty.

Despite the logic of D/FW Commercial’s argument, the court was unpersuaded.⁷⁴ The court specifically relied on the Texas Supreme Court’s 1983 decision in *Gupta v. Ritter Homes, Inc.*⁷⁵ and held that recovery under the DTPA was appropriate.⁷⁶ “By virtue of their lease . . . appellees acquired the benefit of appellant’s services. It is not necessary that the consumer who ‘acquires’ the services be the one who sought the services.”⁷⁷ Unfortunately, the court failed to address the effect of the implied warranty of habitability, an issue in *Gupta* and absent here.

Article 21.21, Texas Insurance Code, as amended, or rules or regulations issued by the State Board of Insurance under Article 21.21, Texas Insurance Code, as amended.

TEX. BUS. & COM. CODE ANN. § 17.50(a) (Vernon 1987).

73. *D/FW Commercial Roofing*, 854 S.W.2d at 186.

74. *Id.*

75. 646 S.W.2d 168 (Tex. 1983) (holding that the absence of privity between a homebuilder and a second owner of the home did not bar the second owner’s DTPA claim against the builder for breach of implied warranties).

76. *D/FW Commercial Roofing*, 854 S.W.2d at 187.

77. *Id.*