

Publications

THE RCLA: A Legislative Attempt to Protect Homeowners and Builders and A Judicial Revision of the Statute to Protect Homeowners

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A Brief Review of the Statute, Recent Changes and Court Opinions and a Discussion of What the Future May Bring

In September of 1989, the Residential Construction Liability Act ("RCLA" or the "Act"), Tex. Prop. Code §§ 27.001 *et. seq.*, first appeared in the Texas Property Code as a means of addressing concerns held by both home buyers and homebuilders alike. It sought to outline remedies available to consumers against homebuilders and to provide a means for the home buyers and homebuilders to resolve disputes relating to alleged construction defects.

Though the Act has been in place for nearly eleven years, there is a relative dearth of cases interpreting the Act and unfortunately, those few cases have created more questions and debates than they have solved. These cases have generally expanded the remedies available to homeowners and eliminated some of the defenses set in place by the Legislature to protect the contractors. As the Supreme Court has yet to weigh in on some of these issues, we do not have a final picture of the statute. However, the trend of the current courts in expanding the homeowner's rights has made the statute less effective in protecting the builders.

The purpose of this paper is to provide attorneys and their clients, whether buyers or builders, with an overview of the RCLA and the current state of that statute, including some speculation on how the Courts may resolve several important questions that have been to date not answered.

A General Review of the RCLA

The RCLA is a statutory scheme which outlines certain defenses available to contractors and limitations on the damages available to homeowners when a lawsuit is brought to recover for alleged residential construction defects. Prior to the Act's inception, a homeowner bringing her cause of action for breach of contract, breach of warranty, negligence or a deceptive trade practice had a wide range of damages available based on the particular legal theories under which she was successful. A contractor, then, could rely on the defenses available based on the particular legal theories under which the Plaintiff was proceeding.

The RCLA is a legislative attempt to unify the causes of action by specifically stating the defenses available to the contractors and types of damages for which a homeowner may seek compensation. It further provides a system for dispute resolution that must be used by the parties. However, it does not create a separate cause of action against a contractor. *See Tex. Prop. Code Sec. 27.005* (Effective for cases filed after September 1, 1999). It merely provides a list of recoverable damages and a list of affirmative defenses that govern any lawsuit regardless of whether it sounds in contract or tort.

When Does the Act Apply?

1. Construction Defects

The RCLA applies to any dispute "resulting from a construction defect, except a claim for personal injury, survival or wrongful death or for damages to goods." Tex. Prop. Code §27.001(a)(1). The Act applies whether is it specifically plead by the homeowner or not. *In re Kimball Homes of Texas, Inc.*, 969 S.W.2d 522, 526 (Tex. App --- Houston [14th Dist.] 1998, no pet. filed)

"Construction defect" is defined very broadly under the Act. It is defined as:

A matter concerning the design, construction or repair of a new residence, [or] an alteration of or addition to an existing residence, or of an appurtenance to a residence, on which a person has a complaint against a contractor. The term may include any physical damage to the residence, any appurtenance, or the real property on which the residence and appurtenance are affixed proximately caused by a construction defect.

Tex. Prop. Code §27.001(2). By its terms, the Act applies to new construction as well as any remodeling or alteration of existing structures.

2. Contractors

While the RCLA applies only to "contractors", that term is defined broadly within the Act. It specifically defines a contractor as "a person contracting with an owner for the construction or sale of a new residence constructed by that person or of an alteration or addition to an existing residence, repair or a new or existing residence or construction sale, alteration addition or repair of an appurtenance to a new or existing residence." Tex. Prop. Code §27.001(3). Contractor is extended to any owner, officer, director, shareholder, partner or employee of the builder.

3. Residences and Appurtenances

As to the type of structures, the Act would appear to be limited to residences. However, its definition of appurtenance may extend coverage to items not automatically included in the typical definition of residence. "Any structure or recreational facility that is appurtenant to a residence, but is not part of the dwelling unit" is an "appurtenance." Tex. Prop. Code §27.000(1) Under this definition, garages, tennis courts, porches, barns, storage sheds and even swimming pools would appear to fall within the RCLA.

When Does the Act Not Apply

1. Personal Injury Claims

By its terms, the RCLA does not apply to personal injury claims brought against a contractor. However, the statute specifically exempts claims for mental anguish from the term "personal injury". In so doing, the legislature addressed a specific problem in the late 1980s when homeowners were able to use the Deceptive Trade Practices Act to recover for mental anguish damages for knowing violations of the DTPA. The recovery of mental anguish damages is, therefore, subject to the RCLA. It is not included in the list of compensable damages, and, therefore, not available in any lawsuit brought against a homeowner where the mental anguish is not tied to physical injury to a person.

2. Subcontractors, Architects, Engineers, Suppliers and Construction Managers

The definition of "contractor" while broad with respect to the types of people in actual privity with the home owner is not broad enough to incorporate any claims against subcontractors, architects, engineers, suppliers or construction management firms. These persons or companies have not generally contracted directly with the homeowner. Therefore, their claims are not subject to the Act.

3. Goods

The RCLA specifically exempts damage to goods. Tex. Prop. Code §27.002 (a)(1). It further defines the term "goods" as to "not include a residence." This exemption is important because of the interplay between the RCLA and the Deceptive Trade Practices Act or DTPA. Tex. Bus & Com. Code Sec. 17.45, *et. seq.* In the 1980s, the typical construction case against the builder included claims filed under the DTPA, which often led to the imposition of huge damage awards under that statute's trebling provisions. Plaintiffs seeking remedies under the DTPA had to show that they were seeking "goods or services" from a defendant and that they were harmed as a result of certain unlawful trade practices in which the defendant engaged. By stating that a "residence" is no longer a "good", it is arguable that the DTPA is no longer a valid cause of action against a homebuilder.

The RCLA further provides that "to the extent of conflict between this chapter and any other law, including the Deceptive Trade Practices --- Consumer Protection Act ("DTPA"), this chapter prevails." Tex. Prop. Code §27.002(a). By redefining goods to eliminate a residence, contractor has a strong argument that a conflict now exists, and the DTPA is completely inapplicable to any residential construction defect matter. 1

4. Exemplary Damages

A recent case has held that the RCLA does not bar the recovery of exemplary damages. ***Sanders v. Construction Equity, Inc.***, 42 S.W.3d 364 (Tex. App.- Beaumont 2001). The Court reasoned that since the RCLA only dealt with compensatory damages, any theory of recovery awarding exemplary damages would not be in conflict with the RCLA. Ignoring the provision of the RCLA that specifically states that only damages set forth within the Act are recoverable, the Court held that "the different purposes of exemplary and

compensatory damages" and "the statute's purpose to compensate for such things as repair costs" meant that the language of §27.002 only governed compensatory damages. Therefore, exemplary damages could still be recovered.

This holding ignores what I believe is the clear language of the statute. In §27.004(h), it states specifically "except as provided by Subsection (f), in a suit subject to this chapter, the claimant may only recover the following damages proximately caused by the construction defect:

- (1) the reasonable cost of repairs necessary to cure any construction defect, including any reasonable and necessary engineering or consulting fees required to evaluate and cure the construction defect, that the contractor is responsible for repairing under this chapter;
- (2) the reasonable expenses of temporary housing reasonably necessary during the repair period;
- (3) the reduction in market value, if any, to the extent the reduction is due to structural failure; and
- (4) reasonable and necessary attorney's fees.

While it is true that these measures of damages are compensatory, it does not mean that exemplary damages can be magically inserted simply because the word "damages" is not defined in the statute. The Beaumont Court of Appeals has created a stretch of the language which may not stand up to scrutiny by the Texas Supreme Court.

5. Fraud

While the Act itself has been silent on whether causes of action brought against a home builder for fraud are covered by the Act, the Courts have had three opportunities to address this issue: ***Bruce v. Jim Walters Homes, Inc.***, 943 S.W.2d 121 (Tex. App. --- San Antonio 1997, writ denied), ***In re Kimball Hill Homes of Texas, Inc.***, 969 S.W.2d 522 (Tex. App. --- Houston [14th Dist.] 1998, no writ), and most recently in June 2001, the Beaumont Court of Appeals issued an opinion on a rehearing of ***Sanders*** cited above in the exemplary damages portion of this paper. ***Sanders v. Construction Equity, Inc.***, 42 S.W.3d 364 (Tex. App.--- Beaumont 2001), on rehearing, 2001 WL 668373 (Tex. App. --- Beaumont 2001).

In ***Bruce***, Jim Walters Homes defended itself against common law fraud, breach of contract, tortious breach of contract, breach of warranty and negligence claims for alleged defects in the Bruce's' home. The San Antonio Court of Appeals held that the fraud causes of action were not pre-empted by the RCLA and could be maintained separate and apart from the Act. The Court reasoned that the wrong sought to be redressed is not the subject of the misrepresentation [the alleged defects], but the act of the misrepresentation itself. 943 S.W.2d at 123.

In **Kimball Homes**, several hundred homeowners sued Kimball for misrepresentations regarding the energy efficiency of their homes and that their homes were constructed using poor quality materials and substandard workmanship. The specific causes of action pleaded were conspiracy, fraud, statutory fraud in a real estate transaction, breach of contract and breach of warranties. The builder sought protection under the RCLA asking for an abatement of the Plaintiffs' claims because the homeowners did not follow the RCLA's scheme for pre-suit notice. To avoid abatement, the homeowners dropped the breach of warranty and breach of contract claims, proceeding solely on their fraud and conspiracy theories.

The Houston Court of Appeals disagreed with the **Bruce** decision by holding that the RCLA applied to the fraud and conspiracy claims. The allegations centered around construction defects even though through artful pleading the Plaintiffs tried to focus on the misrepresentations made. Without the defects, the Court found that there would be no misrepresentations. Misrepresentations as to the energy efficiency of a house only give rise to damages when there are defects in the construction that make the home less energy efficient than promised. Substandard workmanship by its very nature implies that the construction methods employed created defects. According, the Court reasoned that the claims brought by the Plaintiffs were subject to the RCLA.

In **Sanders**, the Beaumont Court of Appeals performed an almost Solomonesque maneuver by holding that the RCLA did apply to the claim and that a fraud claim did conflict with the statute in a limited capacity. The Court cited as an example the limitations on the type and amount of actual damages recoverable. See Tex. Prop.Code Ann. §27.002(a), 27.004 (Vernon 2000). However, the Court refused to limit the recovery of punitive damages. "To read such a limitation into the statute would be to supply language that the Legislature did not provide and, further, would do so in a way that would seem contrary to the public policy of this State-which we believe is to discourage fraud by imposing punitive damages where fraud occurs." 2001 WL 668373, *2.

The reasoning of **Bruce** is very troublesome. Every creative Plaintiff's attorney can find a way to change a particular construction defect into a fraud claim by merely alleging that the contractor misrepresented what he would provide. I believe the better result was reached in **Kimball Homes** When a claim only exists because of defects, it must lie within the RCLA. As noted by the Court in **Kimball Homes**, there are some fraud claims that do not result from defects. Common examples would be misrepresentations made regarding payment of subcontractors, fraud in the price negotiated between the parties or misrepresentations made regarding common areas in a subdivision.

However, the Beaumont Court of Appeals's decision in **Sanders** renders **Kimball Homes** meaningless. The Court bends over backwards to state that it would have to add language to the statute to eliminate punitive damages. I disagree. The statute itself does not limit itself to any type of damages, compensatory, economic, mental anguish, exemplary. It merely says

"damages."

Under the reasoning employed by the Beaumont Court of Appeals, the trebling provision of the DTPA would be available to a Plaintiff whose claims fell under the RCLA as those provisions are not directly countermanded by any provision in the RCLA. Frankly, I consider this reasoning a creative way to avoid the statute and bring back the unlimited jury verdicts of the early 1980s which prompted the creating of this statute. Given the controversial stance taken, *Sanders* may provide the first opportunity for the Texas Supreme Court to issue an opinion on the RCLA. We will simply have to wait and see if the Supreme Court will grant a petition for review, though with the current conservative makeup of the Court they are likely to overturn ***Sanders*** at least with respect to the imposition of punitive damages, even if they follow ***Kimball Homes*** and allow some fraud claims to be maintained.

For now, ***Sanders*** is the law. Practitioners on the homeowners side should couch their lawsuits to seek remedies under the DTPA and for fraud where possible. Practitioners on the home builders side should seek the protection of the RCLA with special exceptions to the Plaintiff's petition and motions for summary judgment. Home builders should also proceed with caution in formulating their offers of settlement and in trying their cases as they may be subjected to damages outside those enumerated in the RCLA.

Pre-Suit Settlement and Notice Provisions

The RCLA has set forth specific provisions intended to allow a homebuilder an opportunity to investigate an alleged problem and resolve it before litigation is necessary.

1. Notice

At least 60 days before suit is filed, a home owner must give the contractor notice of the claim by certified mail, return receipt requested at the builder's last known address. The notice must identify "in reasonable detail the construction defects that are the subject of the complaint." Tex. Prop. Code §27.004(a)

2. Inspection Rights of Contractor

After the contractor receives the notice, he has 35 days to inspect the property that is the subject of the complaint "to determine the nature and cause of the defect and the nature and extent of repair necessary to remedy the defect." Tex. Prop. Code §27.004(a). The contractor may request that the homeowner provide "any evidence that depicts the nature and cause of the defects and the nature and extent of the repairs necessary to remedy the defect, including expert reports, photographs, and videotapes....." *Id.*

3. Offer of Settlement

Within 45 days after the contractor receives the notice, a written offer of

settlement must be made to the homeowner. Tex. Prop. Code §27.004(b). The offer of settlement may include any of the following proposals:

- (1) that the contractor will repair the defect described in the notice letter;
- (2) that the defect will be repaired by another contractor at the expense of original contractor;
- (3) an offer of a monetary settlement for all damages

Tex. Prop. Code §27.004(n).

4. Homeowner's Acceptance or Rejection of Offer

The homeowner has 25 days after the receipt of the offer to accept or reject the offer. After the 25th day, it is considered rejected if it has not been accepted. Tex. Prop. Code §27.004(j).

If a homeowner unreasonably rejects a contractor's written offer of settlement or refuses to permit the contractor a reasonable opportunity to repair the defect, the homeowner's total recovery is limited to the reasonable cost of the repairs that are necessary to cure the construction defect, plus the amount of reasonable and necessary attorneys' fees and costs incurred before the offer was rejected or considered rejected. Id. §27.004(f). Otherwise, the RCLA limits the homeowner's recovery to the following damages proximately caused by the construction defect:

- (1) the reasonable cost of repairs necessary to cure any construction defect that the contractor failed to cure;
- (2) the reasonable expenses of temporary housing reasonably necessary during the repair period;
- (3) the reduction in market value, if any, to the extent the reduction is due to a structural failure; and
- (4) reasonable and necessary attorney's fees.

§27.004(h). Under subsection 27.004(i), however, the total damages that a homeowner may recover against a contractor may not exceed the purchase price of the residence. Id. §27.004(i).

5. Completion of Repairs

From written receipt of the acceptance, a contractor has 45 days to complete repairs "unless completion is delayed by the homeowner or by other events beyond the control of the contractor." Tex. Prop. Code §27.00(b).

6. Defects which Cause an Imminent Threat of Harm

Exempted from this notice scheme are defects which cause an imminent

threat to the health and safety of the inhabitants of the residence. A contractor receiving notice of such a defect shall take reasonable steps to cure the defect as soon as possible. If a contractor fails to have the defect cured, the owner may take such steps necessary to repair the defect and may recover from the contractor the reasonable costs of the repairs, along with any other remedies available under the Act.

Failure to Make a Reasonable Offer under the Act

If a contractor fails to make a reasonable offer or fails to complete the repairs in a good and workmanlike manner, "the limitations on damages and defenses to liability provided for in this section shall not apply." Two cases from the Fort Worth Court of Appeals have addressed the meaning of this language: ***O'Donnell v. Bullivant of Texas, Inc.***, 940 S.W.2d 411 (Tex. App. --- Fort Worth 1997, writ denied) and ***Perry Homes v. Alwattari***, 33 S.W.3d 376 (Tex. App. --- Fort Worth 2000, pet. filed).

In ***O'Donnell***, the homeowners sued their contractor for faulty foundation repairs to their home. The O'Donnells asserted causes of action for negligence, gross negligence, product liability, breach of warranty, breach of contract, and violations of the DTPA. The contractor, Bullivant, moved for summary judgment, asserting that the suit was governed by the RCLA and that under the RCLA, the O'Donnells were entitled to recover no more than the purchase price of their home. The O'Donnells filed a counter motion for partial summary judgment, asserting that the RCLA did not apply because Bullivant failed to make a reasonable written settlement offer. Finding that the RCLA applied to the suit, the trial court granted Bullivant's summary judgment motion and rendered a final judgment for the O'Donnells in the amount of \$44,500, the purchase price of their home.

On appeal, the O'Donnells claimed that the trial court erred in denying their motion for partial summary judgment, on the ground that the RCLA did not apply to their claims because Bullivant failed to make a reasonable settlement offer. *Id.* The Fort Worth Court of Appeals held that Bullivant's settlement offer was unreasonable as a matter of law, and that, under the "clear and unambiguous" language of subsections 27.004(f), (g), (h), and (i), the effect of the unreasonable settlement offer was that the limitation on the amount of damages provided for in subsection 27.004(i) did not apply.

In ***Alwattari***, the Fort Worth Court of Appeals extended the holding in ***O'Donnell***. The Court found that the failure to make a reasonable offer not only eliminated the cap on damages in subsection 27.004(i), but all of the defenses available to the contractor and the limitation on the types of damages recoverable. This ruling allowed the Alwattaris to maintain their action under the DTPA and to recover for types of damages not enumerated in the RCLA.

Frankly, the Fort Worth Court of Appeals may have gone too far with its decision in ***Alwattari***. The effect of failing to make a "reasonable" offer should not be to subject the builder to the DTPA's recovery scheme of punitive damages and mental anguish. It should not open the builder up to causes of action for fraud that would otherwise be pre-empted by the RCLA. Rather, it should be used to eliminate the

cap on damages of the purchase price of the home and to eliminate the affirmative defenses enumerated in §27.003(a).

The Texas Supreme Court has had a Petition for Review on file for a very long time with respect to this matter without yet deciding whether to hear the case. Yet, it is vitally important for the Court to weigh in on the failure to make a reasonable settlement offer. The value of a case dramatically increases with the uncertainties associated with whether a builder made a reasonable offer to resolve the matter. If a builder is subjected to all of the damages available under the DTPA or under theories of fraud, the statute has failed to provide the protection that it originally sought to give. Further, it will require nearly every case to go to trial as a fact issue will almost always exist as to whether the offer made by the builder was reasonable. Hopefully, the Texas Supreme Court will grant the Petition for Review and address these important issues. If the Supreme Court does not, the home builders should be aware that the playing field is slanted very much in favor of the homeowner.

Conclusions

While the Act itself appears to have assisted both homeowners and homebuilders in resolving claims prior to litigation, recent court activity in **Alwattari** and **Sanders** may jeopardize the usefulness of this statute. The legislative intent and history suggests that the Texas legislature meant to provide a simple and quick method to address grievances for their constituents. It was also meant to provide protection to those homebuilders and contractors who tried to address the problems faced by a homeowner, but were unable to come to a resolution before suit was filed. If the failure to provide a reasonable settlement offer in the very early stages of litigation completely emasculates the defenses and protections provided, contractors are again subjected to the same runaway verdicts which brought about the need for the RCLA in the first place.

The Texas Supreme Court can contain some of the damage done by the appellate courts if it would address the issues raised in **Alwattari** and **Sanders**. Otherwise, we may have to wait until 2003 for the legislature to take care of the problems.

In the meantime, I would recommend to all who are advising builders and contractors that the settlement offer stage is the most important stage of the process, moreso than the jury trial itself. The contractors who put the most effort into resolving claims at that point may be the most successful if a settlement cannot be reached. Until the uncertainties raised by **Alwattari** are answered, one should assume that the DTPA applies in full as it did prior to the RCLA=s enactment. Evaluating the case as if treble damages under the DTPA are available may make builders more likely to make an offer that is "reasonable" to any jury. The failure to make such an offer may turn the simple breach of contract case into a much larger verdict that would be difficult to attack on appeal.

The best approach for the general contractor who builds custom homes may be to offer to buy the home back from the Plaintiffs. While that offer is expensive, it is the most likely to be held reasonable by a jury.

For remodeling contractors, offering to hire a neutral party from a list provided by

the Better Business Bureau or a contractor chosen by the Plaintiffs may be reasonable. The original contractor might consider signing the contract with the new contractor and see if some cost savings is available by providing materials or providing a labor pool. Again, it may be more expensive than doing the work in-house, but these type of offers avoid the possibility that the offers will appear unreasonable.

Under ***Sanders*** and ***Alwattari***, practitioners who represent homeowners can be more aggressive in the prosecution of their cases. If the offer made by the homebuilder or its insurance carrier requires broad and overreaching release language or if it does not allow the homeowner options on who may fix the home, a jury may well find the offer was not reasonable. Homeowners should consider taking a strong stance on not letting the same contractor come out to fix the job it originally failed to do. A sympathetic jury may agree that another contractor should do the job and that the original contractor should pay that second contractor.

Also, if the offer does anything less than put the homeowner back in the position they were before the project started, it may be unreasonable. For example, if it does not offer reasonable attorneys fees or offer to compensate the homeowners for inspection fees, a homeowner may take a position that the offer is not reasonable. Remember, reasonableness is a jury question, and a jury full of homeowners is likely to find for the aggrieved homeowner when it can.

Essentially, the current state of the law more strongly favors the homeowners. Practitioners from both sides should approach their cases with that understanding. Until the Supreme Court or the Legislature clarifies the law, the homeowners are in a good position to argue that the full range of damages available under theories of breach of contract, the DTPA and fraud apply. The homebuilder can limit these arguments through a strong initial offer of settlement, but should be prepared to defend the case as if all of these causes of action were viable.

Footnotes

1. *But see, Sanders v. Construction Equity, Inc.*, 42 S.W.3d 364 (Tex.App.-Beaumont 2001) in which the Court held that the DTPA was not pre-empted.

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