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2005 Houston Insurance Seminar

Contemporary Issues in Large Subrogation,

CGL Coverage and Marine Cargo Claims

WEDNESDAY, APRIL 6, 2005
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HOUSTON, TEXAS

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2005 Houston Insurance Seminar

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2005 Houston Insurance Seminar

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AREAS OF EXPERIENCE

- Subrogation & Recovery

EDUCATION

- J.D., Texas Tech University School of Law, 1996
- B.A., Texas Tech University, 1993

MEMBERSHIPS

- Dallas County Bar Association
- Association of Trial Lawyers of America
- Texas Center for Legal Ethics and Professionalism
- Tarrant County Bar Association

William D. Mahoney joined the Firm's Dallas office in May 2003 and practices with the subrogation and recovery department. Prior to joining Cozen O'Connor, William was a trial attorney with the firm of Kern and Wooley LLP in Irving, Texas. William also serves in the United States Army Reserves as a Captain in the Judge Advocate General's Corps.

In 1993, William received his Bachelor of Arts degree in political science from Texas Tech University. He received his law degree from Texas Tech University School of Law in 1996. William is licensed to practice in Texas, as well as before the United States Court of Appeals for the Fifth Circuit and the United States District Courts for the Northern, Southern and Eastern Districts of Texas.

William is a member of the Association of Trial Lawyers of America, the Texas Center for Legal Ethics and Professionalism, the Dallas County Bar Association and the Tarrant County Bar Association.

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AREAS OF EXPERIENCE

- Subrogation & Recovery

EDUCATION

- J.D. Texas Tech University School of Law, 1996
- B.A. Baylor University, 1993

COURT ADMISSIONS

- United States District Court for the Northern, Southern & Western Districts of Texas

MEMBERSHIPS

- Texas State Bar Association
- Texas Young Lawyers' Association

Jason S. Schulze joined Cozen O'Connor in May, 2000 and is a member in the Houston office where he concentrates his practice in subrogation and recovery.

Jason has tried more than 30 cases to jury verdict, and has handled several appeals before the appellate court that serves West Texas.

Jason received his Bachelor of Arts degree from Baylor University in 1993, and earned his law degree at Texas Tech University School of Law in 1996.

Prior to joining the Firm, Jason was an associate with the firm Scherr, Legate, Ehrlich & Kennedy, P.L.L.C., where he litigated and tried personal injury, product liability, employment, and general business cases.

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AREAS OF EXPERIENCE

- Commercial & Complex Litigation
- Insurance Coverage
- Personal Injury
- Professional Liability
- Subrogation & Recovery

EDUCATION

- J.D. Dickinson School of Law, 1978
- B.A. LaSalle University, 1975

MEMBERSHIPS

- Pennsylvania Bar Association
- Philadelphia Bar Association
- Pennsylvania Defense Institute
- State Bar of Texas

Larry Bowman is a Member of the Firm and managing attorney of the Dallas regional office. He concentrates his practice in the areas of commercial and complex litigation.

Mr. Bowman has represented a broad spectrum of individual corporate and insurance company clientele.

Prior to his employment with Cozen O'Connor, Mr. Bowman clerked for The Honorable Robert N.C. Nix, Jr. of the Pennsylvania Supreme Court. While at Cozen O'Connor he was the co-lead counsel in regard to more than $20,000,000 in claims resulting from the allision of the M/V BRIGHT FIELD with the Riverwalk in New Orleans. He has also handled numerous other subrogation and maritime matters, including fires, roof collapses, construction accidents, cargo losses, transportation losses, intermodal cargo cases involving truck/container accidents, bill of lading litigation, allisions and collisions.

He has handled a wide range of civil litigation matters including major property losses, personal injury, commercial litigation of all kinds, and professional liability matters.

He received his undergraduate degree from LaSalle University in 1975 and his J.D. from Dickinson School of Law in 1978.

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Rodney Q. Fonda

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AREAS OF EXPERIENCE

- Cargo Losses
- Maritime Law

EDUCATION

- B.A., Yale University, 1973
- J.D., University of Michigan Law School, 1975

MEMBERSHIPS

- Washington State Bar Association
- Maritime Law Association
- Marine Insurance Association of Seattle

Rodney Q. Fonda joined the firm's Seattle office in April 2003 and practices with the international insurance department. He concentrates his practice on maritime law and related areas such as transportation and inland marine. Prior to joining Cozen O'Connor, Rod was a partner with Madden, Poliak, MacDougall and Williamson.

Rod received his Bachelor of Arts degree from Yale University in 1973. In 1975, he received his law degree from University of Michigan Law School. He is admitted to practice in the State of Washington, as well as before the United States Court of Appeals for the Ninth Circuit.

Rod's specialty is container losses, having represented cargo interests in HYUNDAI SEATTLE, APL CHINA, CSX DISCOVERY and SUSAN MAERSK cases involving multiple containers lost overboard while transiting the Pacific. Between container cases, Rod has represented marine insurers in defense, subrogation and coverage cases involving fishing boats, yachts and shipyard repairs. He has spoken to industry groups on topics such as multimodal carriage, punitive damages in admiralty and release of vessels from marshal's arrest and has been an instructor for Marine Claims classes on behalf of the Marine Insurance Association of Seattle. Rod has been a Proctor in Admiralty of the Maritime Law Association since 1981.

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AREAS OF EXPERIENCE

- Arson & Fraud
- Bad Faith Litigation
- Property Insurance

EDUCATION

- J.D. Florida Coastal School of Law, 1999
- B.A. University of Kentucky, 1994

PUBLICATIONS

- Co-Author "Recent Developments in Property Insurance Law," 37 Tort & Ins. L.J. _____ (2002) – pending publication

Jennifer K. Kenchel joined the firm's Dallas office in July 2001 and practices in the Insurance Litigation department. She concentrates her practice on bad faith litigation, casualty and property defense, insurance coverage, and toxic and other mass torts. Prior to joining Cozen O'Connor, Jennifer served as an intern for the Honorable Hugh A. Carithers in the Fourth Judicial Circuit in Jacksonville, Florida.

Jennifer received her Bachelor of Arts degree in 1994 from the University of Kentucky. In 1999, she received her law degree from Florida Coastal School of Law.

Jennifer is admitted to practice in Texas.

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AREAS OF EXPERIENCE

- Advertising Liability and Personal Injury
- Alternative Dispute Resolution
- Appellate Practice
- Bad Faith Litigation
- Business Torts
- Commercial General Liability
- Construction Liability
- Directors' & Officers' Liability
- Employment Practices
- Environmental Coverage
- Excess and Surplus Lines
- Personal Lines
- Premises & Security Liability
- Products Liability
- Professional Liability
- Property Insurance
- Punitive Damages
- Toxic & Other Mass Torts

EDUCATION

- J.D., Baylor University Law School, 1983
- B.A., Rice University, 1979

BAR ADMISSIONS

- Texas

COURT ADMISSIONS

- United States District Courts for the Eastern, Northern, Southern and Western Districts of Texas
- United States Courts of Appeals, Fifth and Federal Circuits
- United States Supreme Court

MEMBERSHIPS

- American Bar Association
- Houston Bar Association
- Texas Association of Civil Trial and Appellate Specialists
- Texas Association of Defense Counsel
- Defense Research Institute
- Bar Associations of the Fifth and Federal Circuits

Gene F. Creely, II is a Member of the Firm, where he concentrates his practice in insurance coverage, bad faith and products liability matters. Gene joined the Houston office of Cozen O'Connor in January 2005, having previously practiced at McGlinchey Stafford PLLC in Houston.

Gene has successfully tried numerous cases to verdict in the Texas state and federal trial courts. He is also a board-certified appellate attorney and has been involved in appeals at various levels in both the Texas state and federal appellate courts. He is a certified mediator and has participated in numerous mediations and arbitrations.

Gene has extensive experience representing domestic and foreign insurance companies and underwriters in regard to matters involving complex insurance coverage issues. He has rendered numerous coverage opinions including those relating to coverage for intellectual property claims. He is a frequent author and lecturer on various insurance coverage-related topics. Gene has been awarded the highest possible rating of "AV" by Martindale-Hubbell, the preeminent, national directory of attorneys.

Gene earned his Bachelor of Arts degree in economics and managerial studies from Rice University in 1979 and his law degree from Baylor University in 1983. He is admitted to practice in Texas.

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RECENT CHANGES TO THE RESIDENTIAL CONSTRUCTION LIABILITY ACT (RCLA) AND THE NEW RESIDENTIAL CONSTRUCTION COMMISSION ACT (RCCA)

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Recent Changes To The Residential Construction Liability Act (RCLA) and The NEW Residential Construction Commission Act (RCCA)

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

H.B. No. 730

- Effective date: September 1, 2003
- Created 9 Member RCCA Commission
  - Adopted rules for state-sponsored inspection and dispute resolution process
  - Established "building and performance standards"
  - Established limited statutory warranties
  - Approving 3rd party warranty companies and inspectors
  - Commission appointed on December 1, 2003

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

WHAT DOES RCCA APPLY TO?

- A dispute between a Builder and a Homeowner;
- Arising out of a construction defect

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

WHO IS A "BUILDER?"

- Any business/individual who for $ constructs, supervises or manages the construction of:
- A new home;
- A material improvement to a home; or
- An interior improvement over $20,000.

- **NOTE** - Work performed solely to replace or repair a roof is **exempted** from RCCA.

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

WHO IS A "HOMEOWNER?"

- A person who owns a home; or
- A subrogee or assignee of a person who owns a home (Insurer)???;
- Also applies to Insurers through revision to RCLA (Property Code §27.004)???.

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

WHAT IS A "CONSTRUCTION DEFECT?"

- The failure of a home to meet the applicable warranty, building and performance standards during the warranty period, and
- Any physical damage to the home proximately caused by that failure.
- The Builder is not liable for damage caused by the negligence of third parties, "normal wear and tear," "deterioration" or "normal shrinkage."

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

BUILDING & PERFORMANCE STANDARDS

- Adopted by Commission
- Comply with international and national building codes
- Effective for homes where construction commenced after June 1, 2005
  - -Homes constructed before adoption then written warranty applies or "usual practices" applies
- Creating Mold Reduction Task Force

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

BUILDING & PERFORMANCE STANDARDS

- Final standards published 10/22/04
- Available on-line:

http://www.trcc.state.tx.us/links/warranties.htm

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

BUILDING & PERFORMANCE STANDARDS

- Limits Builder responsibilities (specific standards)
- Establishes Homeowner's duties
  - Most homeowners not aware of detailed maintenance requirements
  - Examples: caulking; grading; landscape watering
  - Provides built-in defense
- Builder not responsible for compliance if Homeowner delays in reporting construction defect (undefined)

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

STATUTORY WARRANTY

- 1 Year for workmanship and materials
- 2 Years for plumbing, electrical, heating, A/C
- 10 Years for major structural components

-All warranties include "warranty of habitability"

-No waivers of statutory warranty

-No implied warranties

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

STATUTORY WARRANTIES CONTINUED...

- All common-law warranties are gone;
- The "warranty of habitability" means a Builder's obligation to construct a home or home improvement that is in compliance with the limited statutory warranties and building and performance standards adopted by the Commission under §430.001 and that is safe, sanitary, and fit for humans to inhabit.
- The defect must have a direct adverse effect on the habitable areas of the home.

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

PREREQUISITES TO SUIT

- Homeowner must give written notice of the defect and submit claim to state-sponsored inspection before performing any repairs;
- Insurer must also provide Builder with an opportunity to inspect and offer to repair under RCLA §27.004.

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

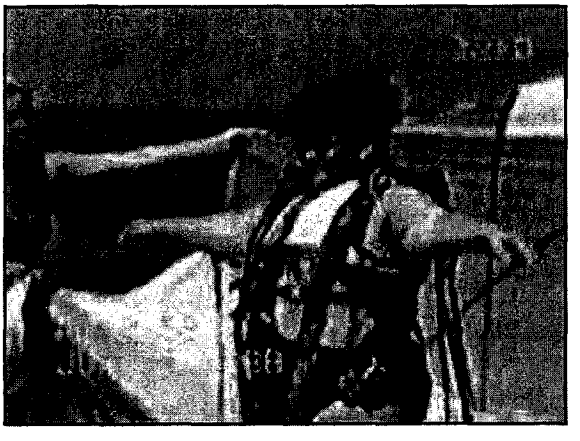
DEADLINES TO WATCH

- 10 Yr Statute of Repose
- 2 Yrs to request Inspection/Dispute Resolution
  -or 30 days after warranty expires (1 yr warranty)
- 2 or 4 Yr Statute of Limitations
- 45 days after Inspector issues recommendation
  -or 45 days after Panel ruling on appeal
- Damage to goods must be included in action

RECENT CHANGES TO Residential Construction Liability Act (RCLA) and NEW Residential Construction Commission Act (RCCA)

MISCELLANEOUS

- The determination of the third-party inspector establishes a rebuttable presumption.
- Overturning the determination of the third-party inspector requires a finding by a preponderance of the evidence.
- If a party wants to appeal the final state-sponsored ADR ruling, there is a rebuttable presumption in favor of the panel's ruling.
- Overturning the ADR ruling requires a finding by a preponderance of the evidence.



TEXAS RESIDENTIAL CONSTRUCTION LIABILITY ACT

SECTION 27.001-27.007 Texas Property Code

I. What It Applies To

A. "Any action to recover damages resulting from a construction defect..." 27.002(a)

1. **Definition**-construction defect "...a matter concerning the design, construction, or repair of a new residence, of an alteration of or repair 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" 27.001(4)

2. Also includes construction or sale of a new residence constructed by the contractor or of an alteration of or addition to an existing residence, repair of a new or existing residence, or construction, sale, alteration, addition, or repair of an appurtenance to a new or existing residence. 27.001(5)

B. Exceptions

1. Personal Injury (not mental anguish claims)

2. Survival Claims

3. Wrongful Death Claims

4. **Damage to Goods**

a. **Goods does not mean residence;**

b. Contents, inventory, and all other personal property.

II. Who It Applies To

Contractor-including owner, officer, director, shareholder, partner, or employee of the contractor

III. Who Can Bring A Claim

A. Insurance Company [assignee/subrogee]

B. Owner

C. Subsequent Purchaser of the Residence

IV. Damages

A. The contractor is not liable for **any** damages resulting from:

1. Negligence of a person other than the contractor, his agent, employee, or subcontractor;

2. Normal wear, tear or deterioration;

3. Normal shrinkage due to drying or settlement of construction components within the tolerance of building standards;

4. The contractor's reliance on written information obtained from official government records, if the information was false or inaccurate and the contractor did not know of the falsity or inaccuracy of the information (information must relate to the residence, appurtenance, or real property on which the residence and appurtenance are affixed)

B. Recoverable Damages

1. Reasonable costs of repair;

2. Reasonable replacement cost for goods;

3. Expert/consulting fees;

4. Temporary housing (additional living expenses);

5. Reduction in "current" market value of residence; and

6. Attorney's fees.

C. Total damages cannot exceed the greater of the claimant's purchase price for the residence or the current fair market value of the residence without the construction defect. 27.004(*i*)

V. NOTICE REQUIREMENTS

A. Section 27.003(2)

"...if an assignee of the claimant or a person subrogated to the rights of a claimant fails to provide the contractor with the written notice and opportunity to inspect and offer to repair required by Section 27.004(a) *or fails to request state-sponsored inspection and dispute resolution under Chapter 428, if applicable,* **before performing repairs**, the contractor is **not liable** for the cost of any repairs or any percentage of damages caused by repairs made to a construction defect at the request of an assignee of the claimant or a person subrogated to the rights of a claimant by a person other than the contractor or an agent, employee, or subcontractor of the contractor." (emphasis added)

In other words:

> **Must provide written notice to the contractor before performing repairs.**

Otherwise,

> The contractor is not liable for the cost of any repairs or any percentage of damages caused by repairs.

B. Time Line (See Chart)

1. Sixty (60) days before filing suit against the contractor, you must:

   a. send written notice;

   b. by certified mail, return receipt requested;

   c. to contractor at contractor's last known address; and

   d. state in reasonable detail what the construction defects are.

2. Thirty-five (35) days after the contractor receives notice (the date on the return receipt):

   a. if the contractor requests in writing, they must have a reasonable opportunity to inspect the residence.

3. Forty-five (45) days after the contractor gets notice:

   a. the contractor may make an offer of settlement, and that offer must be sent by certified mail, return receipt requested

   b. offer may include

      1. agreement by contractor to repair, or

      2. agreement by contractor to have repairs fixed by an independent contractor at the contractor's expense, or

      3. a monetary settlement offer

   c. the offer must describe in reasonable detail the repairs to be made

4. Twenty-five (25) days after you receive the contractor's written offer of settlement, if you agree to the settlement:

   a. you must accept in writing, or else

   b. the offer is considered rejected. 27.004(i)

5. Forty-five (45) days after the contractor receives written notice of acceptance of the settlement offer the contractor must make repairs, unless

   a completion delayed by the claimant, or

   b events beyond the control of contractor (acts of God, etc.)

C. Contractor and Claimant may agree in writing to extend or modify these deadlines

D. Abatement provision

1. Even if you don't give sixty (60) days notice before suit, can still file to protect the statute of limitations. 27.004(c)

2. CAUTION: If the abatement is not appropriate (i.e., statute of limitations did not need protecting), the Court "shall" dismiss the action. 27.004(d)

E. If you reject the contractor's offer, or do not give the contractor an opportunity to repair;

1. The rejection cannot be unreasonable, otherwise

2. Damages are limited to the amount for repairs or the amount of the contractor's reasonable settlement offer

F. Mediation. Section 27.0041

1. If damages are greater than $7,500, either party may file a motion to compel mediation

2. The motion must be filed no later than ninety (90) days after the date that a suit is filed

PROPERTY CODE

CHAPTER 27. RESIDENTIAL CONSTRUCTION LIABILITY

Sec. 27.001. DEFINITIONS. In this chapter:

(1) "Action" means a court or judicial proceeding or an arbitration.

(2) "Appurtenance" means any structure or recreational facility that is appurtenant to a residence but is not a part of the dwelling unit.

(3) "Commission" means the Texas Residential Construction Commission.

(4) "Construction defect" has the meaning assigned by Section 401.004 for an action to which Subtitle D, Title 16, applies and for any other action means a matter concerning the design, construction, or repair of a new residence, of an alteration of or repair 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.

(5) "Contractor" means a builder, as defined by Section 401.003, and any person contracting with an owner for the construction or sale of a new residence constructed by that person or of an alteration of or addition to an existing residence, repair of a new or existing residence, or construction, sale, alteration, addition, or repair of an appurtenance to a new or existing residence. The term includes:

(A) an owner, officer, director, shareholder, partner, or employee of the contractor; and

(B) a risk retention group registered under Article 21.54, Insurance Code, that insures all or any part of a contractor's liability for the cost to repair a residential construction defect.

(6) "Economic damages" means compensatory damages for pecuniary loss proximately caused by a construction defect. The term does not include exemplary damages or damages for physical pain and mental anguish, loss of consortium, disfigurement,

physical impairment, or loss of companionship and society.

(7) "Residence" means the real property and improvements for a single-family house, duplex, triplex, or quadruplex or a unit in a multiunit residential structure in which title to the individual units is transferred to the owners under a condominium or cooperative system.

(8) "Structural failure" has the meaning assigned by Section 401.002 for an action to which Subtitle D, Title 16, applies and for any other action means actual physical damage to the load-bearing portion of a residence caused by a failure of the load-bearing portion.

(9) "Third-party inspector" has the meaning assigned by Section 401.002.

Added by Acts 1989, 71st Leg., ch. 1072, Sec. 1, eff. Sept. 1, 1989. Amended by Acts 1993, 73rd Leg., ch. 797, Sec. 1, 2 eff. Aug. 30, 1993; Acts 1999, 76th Leg., ch. 189, Sec. 1, eff. Sept. 1, 1999; Acts 2003, 78th Leg., ch. 458, Sec. 2.01, eff. Sept. 1, 2003.

Sec. 27.002. APPLICATION OF CHAPTER. (a) This chapter applies to:

(1) any action to recover damages or other relief arising from a construction defect, except a claim for personal injury, survival, or wrongful death or for damage to goods; and

(2) any subsequent purchaser of a residence who files a claim against a contractor.

(b) To the extent of conflict between this chapter and any other law, including the Deceptive Trade Practices-Consumer Protection Act (Subchapter E, Chapter 17, Business & Commerce Code) or a common law cause of action, this chapter prevails.

(c) In this section:

(1) "Goods" does not include a residence.

(2) "Personal injury" does not include mental anguish.

(d) This chapter does not apply to an action to recover damages that arise from:

(1) a violation of Section 27.01, Business & Commerce Code;

(2) a contractor's wrongful abandonment of an improvement project before completion; or

(3) a violation of Chapter 162.

Added by Acts 1989, 71st Leg., ch. 1072, Sec. 1, eff. Sept. 1, 1989. Amended by Acts 1993, 73rd Leg., ch. 797, Sec. 3, eff. Aug. 30, 1993; Acts 1999, 76th Leg., ch. 189, Sec. 2, eff. Sept. 1, 1999; Acts 2003, 78th Leg., ch. 458, Sec. 2.02, eff. Sept. 1, 2003.

Sec. 27.003. LIABILITY. (a) In an action to recover damages or other relief arising from a construction defect:

(1) a contractor is not liable for any percentage of damages caused by:

(A) negligence of a person other than the contractor or an agent, employee, or subcontractor of the contractor;

(B) failure of a person other than the contractor or an agent, employee, or subcontractor of the contractor to:

(i) take reasonable action to mitigate the damages; or

(ii) take reasonable action to maintain the residence;

(C) normal wear, tear, or deterioration;

(D) normal shrinkage due to drying or settlement of construction components within the tolerance of building standards; or

(E) the contractor's reliance on written information relating to the residence, appurtenance, or real property on which the residence and appurtenance are affixed that was obtained from official government records, if the written information was false or inaccurate and the contractor did not know and could not reasonably have known of the falsity or inaccuracy of the information; and

(2) if an assignee of the claimant or a person subrogated to the rights of a claimant fails to provide the contractor with the written notice and opportunity to inspect and offer to repair required by Section 27.004 or fails to request state-sponsored inspection and dispute resolution under Chapter 428, if applicable, before performing repairs, the contractor is not liable for the cost of any repairs or any percentage of damages caused by repairs made to a construction defect at the request of an

assignee of the claimant or a person subrogated to the rights of a claimant by a person other than the contractor or an agent, employee, or subcontractor of the contractor.

(b) Except as provided by this chapter, this chapter does not limit or bar any other defense or defensive matter or other defensive cause of action applicable to an action to recover damages or other relief arising from a construction defect.

Added by Acts 1989, 71st Leg., ch. 1072, Sec. 1, eff. Sept. 1, 1989. Amended by Acts 1993, 73rd Leg., ch. 797, Sec. 4, eff. Aug. 30, 1993; Acts 1999, 76th Leg., ch. 189, Sec. 3, eff. Sept. 1, 1999; Acts 2003, 78th Leg., ch. 458, Sec. 2.03, eff. Sept. 1, 2003.

Sec. 27.0031. FRIVOLOUS SUIT; HARASSMENT. A party who files a suit under this chapter that is groundless and brought in bad faith or for purposes of harassment is liable to the defendant for reasonable and necessary attorney's fees and court costs.

Added by Acts 1999, 76th Leg., ch. 189, Sec. 4, eff. Sept. 1, 1999.

Sec. 27.004. NOTICE AND OFFER OF SETTLEMENT. (a) In a claim not subject to Subtitle D, Title 16, before the 60th day preceding the date a claimant seeking from a contractor damages or other relief arising from a construction defect initiates an action, the claimant shall give written notice by certified mail, return receipt requested, to the contractor, at the contractor's last known address, specifying in reasonable detail the construction defects that are the subject of the complaint. On the request of the contractor, the claimant shall provide to the contractor any evidence that depicts the nature and cause of the defect and the nature and extent of repairs necessary to remedy the defect, including expert reports, photographs, and videotapes, if that evidence would be discoverable under Rule 192, Texas Rules of Civil Procedure. During the 35-day period after the date the contractor receives the notice, and on the contractor's written request, the contractor shall be given a reasonable opportunity to inspect and have inspected the property that is the subject of the complaint to determine the nature and cause of the defect and the nature and extent of repairs necessary to remedy the defect. The contractor may take reasonable steps to document the defect. In a claim subject to Subtitle D, Title 16, a contractor is entitled to

make an offer of repair in accordance with Subsection (b). A claimant is not required to give written notice to a contractor under this subsection in a claim subject to Subtitle D, Title 16.

(b) Not later than the 15th day after the date of a final, unappealable determination of a dispute under Subtitle D, Title 16, if applicable, or not later than the 45th day after the date the contractor receives the notice under this section, if Subtitle D, Title 16, does not apply, the contractor may make a written offer of settlement to the claimant. The offer must be sent to the claimant at the claimant's last known address or to the claimant's attorney by certified mail, return receipt requested. The offer may include either an agreement by the contractor to repair or to have repaired by an independent contractor partially or totally at the contractor's expense or at a reduced rate to the claimant any construction defect described in the notice and shall describe in reasonable detail the kind of repairs which will be made. The repairs shall be made not later than the 45th day after the date the contractor receives written notice of acceptance of the settlement offer, unless completion is delayed by the claimant or by other events beyond the control of the contractor. If a contractor makes a written offer of settlement that the claimant considers to be unreasonable:

(1) on or before the 25th day after the date the claimant receives the offer, the claimant shall advise the contractor in writing and in reasonable detail of the reasons why the claimant considers the offer unreasonable; and

(2) not later than the 10th day after the date the contractor receives notice under Subdivision (1), the contractor may make a supplemental written offer of settlement to the claimant by sending the offer to the claimant or the claimant's attorney.

(c) If compliance with Subtitle D, Title 16, or the giving of the notice under Subsections (a) and (b) within the period prescribed by those subsections is impracticable because of the necessity of initiating an action at an earlier date to prevent expiration of the statute of limitations or if the complaint is asserted as a counterclaim, compliance with Subtitle D, Title 16, or the notice is not required. However, the action or counterclaim

shall specify in reasonable detail each construction defect that is the subject of the complaint. If Subtitle D, Title 16, applies to the complaint, simultaneously with the filing of an action by a claimant, the claimant must submit a request under Section 428.001. If Subtitle D, Title 16, does not apply, the inspection provided for by Subsection (a) may be made not later than the 75th day after the date of service of the suit, request for arbitration, or counterclaim on the contractor, and the offer provided for by Subsection (b) may be made not later than the 15th day after the date the state-sponsored inspection and dispute resolution process is completed, if Subtitle D, Title 16, applies, or not later than the 60th day after the date of service, if Subtitle D, Title 16, does not apply. If, while an action subject to this chapter is pending, the statute of limitations for the cause of action would have expired and it is determined that the provisions of Subsection (a) were not properly followed, the action shall be abated to allow compliance with Subsections (a) and (b).

(d) The court or arbitration tribunal shall dismiss an action governed by this chapter if Subsection (c) does not apply and the court or tribunal, after a hearing, finds that the contractor is entitled to dismissal because the claimant failed to comply with the requirements of Subtitle D, Title 16, if applicable, failed to provide the notice or failed to give the contractor a reasonable opportunity to inspect the property as required by Subsection (a), or failed to follow the procedures specified by Subsection (b). An action is automatically dismissed without the order of the court or tribunal beginning on the 11th day after the date a motion to dismiss is filed if the motion:

(1) is verified and alleges that the person against whom the action is pending did not receive the written notice required by Subsection (a), the person against whom the action is pending was not given a reasonable opportunity to inspect the property as required by Subsection (a), or the claimant failed to follow the procedures specified by Subsection (b) or Subtitle D, Title 16; and

(2) is not controverted by an affidavit filed by the claimant before the 11th day after the date on which the motion to

dismiss is filed.

(e) If a claimant rejects a reasonable offer made under Subsection (b) or does not permit the contractor or independent contractor a reasonable opportunity to inspect or repair the defect pursuant to an accepted offer of settlement, the claimant:

(1) may not recover an amount in excess of:

(A) the fair market value of the contractor's last offer of settlement under Subsection (b); or

(B) the amount of a reasonable monetary settlement or purchase offer made under Subsection (n); and

(2) may recover only the amount of reasonable and necessary costs and attorney's fees as prescribed by Rule 1.04, Texas Disciplinary Rules of Professional Conduct, incurred before the offer was rejected or considered rejected.

(f) If a contractor fails to make a reasonable offer under Subsection (b), the limitations on damages provided for in Subsection (e) shall not apply.

(g) Except as provided by Subsection (e), in an action subject to this chapter the claimant may recover only the following economic damages proximately caused by a construction defect:

(1) the reasonable cost of repairs necessary to cure any construction defect;

(2) the reasonable and necessary cost for the replacement or repair of any damaged goods in the residence;

(3) reasonable and necessary engineering and consulting fees;

(4) the reasonable expenses of temporary housing reasonably necessary during the repair period;

(5) the reduction in current market value, if any, after the construction defect is repaired if the construction defect is a structural failure; and

(6) reasonable and necessary attorney's fees.

(h) A homeowner and a contractor may agree in writing to extend any time period described in this chapter.

(i) An offer of settlement made under this section that is not accepted before the 25th day after the date the offer is received by the claimant is considered rejected.

(j) An affidavit certifying rejection of a settlement offer under this section may be filed with the court or arbitration tribunal. The trier of fact shall determine the reasonableness of a final offer of settlement made under this section.

(k) A contractor who makes or provides for repairs under this section is entitled to take reasonable steps to document the repair and to have it inspected.

(l) If Subtitle D, Title 16, applies to the claim and the contractor's offer of repair is accepted by the claimant, the contractor, on completion of the repairs and at the contractor's expense, shall engage the third-party inspector who provided the recommendation regarding the construction defect involved in the claim to inspect the repairs and determine whether the residence, as repaired, complies with the applicable limited statutory warranty and building and performance standards adopted by the commission. The contractor is entitled to a reasonable period not to exceed 15 days to address minor cosmetic items that are necessary to fully complete the repairs. The determination of the third-party inspector of whether the repairs comply with the applicable limited statutory warranty and building and performance standards adopted by the commission establishes a rebuttable presumption on that issue. A party seeking to dispute, vacate, or overcome that presumption must establish by clear and convincing evidence that the determination is inconsistent with the applicable limited statutory warranty and building and performance standards.

(m) Notwithstanding Subsections (a), (b), and (c), a contractor who receives written notice of a construction defect resulting from work performed by the contractor or an agent, employee, or subcontractor of the contractor and creating an imminent threat to the health or safety of the inhabitants of the residence shall take reasonable steps to cure the defect as soon as practicable. If the contractor fails to cure the defect in a reasonable time, the owner of the residence may have the defect cured and may recover from the contractor the reasonable cost of the repairs plus attorney's fees and costs in addition to any other damages recoverable under any law not inconsistent with the provisions of this chapter.

(n) This section does not preclude a contractor from making a monetary settlement offer or an offer to purchase the residence.

(o) A notice and response letter prescribed by this chapter must be sent by certified mail, return receipt requested, to the last known address of the recipient. If previously disclosed in writing that the recipient of a notice or response letter is represented by an attorney, the letter shall be sent to the recipient's attorney in accordance with Rule 21a, Texas Rules of Civil Procedure.

(p) If the contractor provides written notice of a claim for damages arising from a construction defect to a subcontractor, the contractor retains all rights of contribution from the subcontractor if the contractor settles the claim with the claimant.

(q) If a contractor refuses to initiate repairs under an accepted offer made under this section, the limitations on damages provided for in this section shall not apply.

Added by Acts 1989, 71st Leg., ch. 1072, Sec. 1, eff. Sept. 1, 1989. Amended by Acts 1993, 73rd Leg., ch. 797, Sec. 5, eff. Aug. 30, 1993; Acts 1995, 74th Leg., ch. 414, Sec. 10, eff. Sept. 1, 1995; Acts 1999, 76th Leg., ch. 189, Sec. 5, eff. Sept. 1, 1999; Acts 2003, 78th Leg., ch. 458, Sec. 2.04, eff. Sept. 1, 2003.

Sec. 27.0041. MEDIATION. (a) If a claimant files suit seeking from a contractor damages arising from a construction defect in an amount greater than $7,500, the claimant or contractor may file a motion to compel mediation of the dispute. The motion must be filed not later than the 90th day after the date the suit is filed.

(b) Not later than the 30th day after the date a motion is filed under Subsection (a), the court shall order the parties to mediate the dispute. If the parties cannot agree on the appointment of a mediator, the court shall appoint the mediator.

(c) The court shall order the parties to begin mediation of the dispute not later than the 30th day after the date the court enters its order under Subsection (b) unless the parties agree otherwise or the court determines additional time is required. If the court determines that additional time is required, the court

may order the parties to begin mediation of the dispute not later than the 60th day after the date the court enters its order under Subsection (b).

(d) Unless each party who has appeared in a suit filed under this chapter agrees otherwise, each party shall participate in the mediation and contribute equally to the cost of the mediation.

(e) Section 154.023, Civil Practice and Remedies Code, and Subchapters C and D, Chapter 154, Civil Practice and Remedies Code, apply to a mediation under this section to the extent those laws do not conflict with this section.

Added by Acts 1999, 76th Leg., ch. 189, Sec. 6, eff. Sept. 1, 1999.

Sec. 27.0042. CONDITIONAL SALE TO BUILDER. (a) A written agreement between a contractor and a homeowner may provide that, except as provided by Subsection (b), if the reasonable cost of repairs necessary to repair a construction defect that is the responsibility of the contractor exceeds an agreed percentage of the current fair market value of the residence, as determined without reference to the construction defects, then, in an action subject to this chapter, the contractor may elect as an alternative to the damages specified in Section 27.004(g) that the contractor who sold the residence to the homeowner purchase it.

(b) A contractor may not elect to purchase the residence under Subsection (a) if:

(1) the residence is more than five years old at the time an action is initiated; or

(2) the contractor makes such an election later than the 15th day after the date of a final, unappealable determination of a dispute under Subtitle D, Title 16, if applicable.

(c) If a contractor elects to purchase the residence under Subsection (a):

(1) the contractor shall pay the original purchase price of the residence and closing costs incurred by the homeowner and the cost of transferring title to the contractor under the election;

(2) the homeowner may recover:

(A) reasonable and necessary attorney's and expert fees as identified in Section 27.004(g);

(B) reimbursement for permanent improvements the owner made to the residence after the date the owner purchased the residence from the builder; and

(C) reasonable costs to move from the residence; and

(3) conditioned on the payment of the purchase price, the homeowner shall tender a special warranty deed to the contractor, free of all liens and claims to liens as of the date the title is transferred to the contractor, and without damage caused by the homeowner.

(d) An offer to purchase a claimant's home that complies with this section is considered reasonable absent clear and convincing evidence to the contrary.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 2.05, eff. Sept. 1, 2003.

Sec. 27.005. LIMITATIONS ON EFFECT OF CHAPTER. This chapter does not create a cause of action or derivative liability or extend a limitations period.

Added by Acts 1989, 71st Leg., ch. 1072, Sec. 1, eff. Sept. 1, 1989. Amended by Acts 1999, 76th Leg., ch. 189, Sec. 7, eff. Sept. 1, 1999.

Sec. 27.006. CAUSATION. In an action to recover damages resulting from a construction defect, the claimant must prove that the damages were proximately caused by the construction defect.

Added by Acts 1993, 73rd Leg., ch. 797, Sec. 6, eff. Aug. 30, 1993.

Sec. 27.007. DISCLOSURE STATEMENT REQUIRED. (a) A written contract subject to this chapter must contain next to the signature lines in the contract a notice printed or typed in 10-point boldface type or the computer equivalent that reads substantially similar to the following:

"This contract is subject to Chapter 27 of the Texas Property Code. The provisions of that chapter may affect your right to recover damages arising from the performance of this contract. If you have a complaint concerning a construction defect arising from the performance of this contract and that defect has not been corrected through normal warranty service, you must provide the notice required by Chapter 27 of the Texas Property Code to the

contractor by certified mail, return receipt requested, not later than the 60th day before the date you file suit to recover damages in a court of law or initiate arbitration. The notice must refer to Chapter 27 of the Texas Property Code and must describe the construction defect. If requested by the contractor, you must provide the contractor an opportunity to inspect and cure the defect as provided by Section 27.004 of the Texas Property Code."

(b) If a contract does not contain the notice required by this section, the claimant may recover from the contractor a civil penalty of $500 in addition to any other remedy provided by this chapter.

Added by Acts 1999, 76th Leg., ch. 189, Sec. 8, eff. Sept. 1, 2000. Amended by Acts 2003, 78th Leg., ch. 458, Sec. 2.06, eff. Sept. 1, 2003.

TEXAS RESIDENTIAL CONSTRUCTION COMMISSION ACT
HOUSE BILL 730

I. Establishes Commission (RCCA)

A. Nine members (4 builders; 1 engineer; 1 architect; 3 public)

B. Adopts rules for state-sponsored inspection and dispute resolution

C. To establish building and performance standards/limited warranties;

D. To approve third-party warranty companies and inspectors

E. Must be appointed by 12/01/03

F. Builder Registration
   1. Certificate of registration
      a. stricter eligibility standards/renewal every 2 years
      b. integrity standards
   2. Builder must register each new home within 15 days
   3. Effective March 1, 2004
   4. Establish written complaint file
   5. Creates "Texas Star Builder" Program

II. Subrogation

A. Before repair Insurer must give:
   1. Written notice;
   2. Opportunity to inspect;
   3. Offer to repair; or
   4. Request state-sponsored inspection under TRCC.

III. Warranty

A. Commission to adopt warranties
   1. Must comply with international and national building codes
   2. All warranties include "warranty of habitability"
   3. Mold reduction and remediation task force

B. Homes constructed before adoption
   1. Written warranty sets standards
   2. If no warranty, "usual and customary practices"

C. Applicable after finalized by Commission
   1. Exclusion for distressed areas within 50 miles of border

D. Exclusive warranty
   1. No implied warranties
   2. No waiver

E. Statutory Warranty
   1. 1 year for workmanship and materials
   2. 2 years for plumbing, electrical, heating, A/C
   3. 10 years for major structural components

IV. Dispute Resolution Process

A. May be requested by Homeowner or Builder
   1. Builder does not include roof repair only or interior improvements under $20,000

B. Excludes PI and damage to goods

C. Deadlines
   1. 10 years to submit request to Commission
   2. 2 years to request inspection and dispute resolution or
      a. 30 days after warranty expires
   3. Regular statute of limitations
   4. Deadline to file suit
      a. 45 days after 3rd party inspector issues recommendation
      b. 45 days after Commission issues ruling on appeal

D. Claims for PI and damage to goods must be included in action

E. Failure to comply results in dismissal instead of abatement

F. 3rd party inspector/panel of inspectors
   1. Recommendation creates rebuttable presumption
   2. Opposing party must establish error by preponderance

G. If Inspector finds for requesting party, Commission may order other party to pay costs of requesting party's inspections and fees

H. Settlement Offers
   1. Recovery limited if offer rejected
      a. limited to FMV of last offer or reasonable monetary offer
   2. If no offer
      a. damages not limited
   3. Inspector approves repairs (new presumption of compliance)
   4. If imminent threat, builder must cure as soon as possible

I. Damages Available
   1. Reasonable cost of repairs
   2. Damaged goods
   3. Engineering and consulting fees
   4. ALE
   5. Reduction in current market value if structural
   6. Attorney's fees

V. Arbitration

A. Effective Provisions for arbitrations initiated on or after 9/1/03

B. Residential Construction Arbitrator
   1. 5 years arbitration experience with construction defects
   2. Continuing education requirements
   3. 2 year renewal requirement

C. Filing awards
   1. Filing of award provisions applicable after 1/1/04
   2. Venue is county of subject residence
   3. Award must be filed

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TITLE 16. TEXAS RESIDENTIAL CONSTRUCTION COMMISSION ACT

SUBTITLE A. GENERAL PROVISIONS

CHAPTER 401. GENERAL PROVISIONS

Sec. 401.001. SHORT TITLE. This title may be cited as the Texas Residential Construction Commission Act.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 401.002. GENERAL DEFINITIONS. In this title:

(1) "Applicable building and performance standards" means:

(A) building and performance standards adopted under Section 430.001; or

(B) for homes constructed before the adoption of building and performance standards under Section 430.001, the building and performance standards under any express warranty provided in writing by the builder or, if there is no express warranty, the usual and customary residential construction practices in effect at the time of the construction.

(2) "Applicable warranty period" means:

(A) a warranty period established under Section 430.001; or

(B) for construction to which the warranty periods adopted under Section 430.001 do not apply, any other construction warranty period that applies to the construction.

(3) "Approved architect" means an architect licensed by this state and approved by the commission to provide services to the commission in connection with the state-sponsored inspection and dispute resolution process.

(4) "Approved structural engineer" means a licensed professional engineer approved by the commission to provide services to the commission in connection with the state-sponsored inspection and dispute resolution process.

(5) "Commission" means the Texas Residential Construction Commission.

(6) "Home" means the real property and improvements and appurtenances for a single-family house or duplex.

(7) "Homeowner" means a person who owns a home or a subrogee or assignee of a person who owns a home.

(8) "Limited statutory warranty and building and performance standards" means the limited statutory warranty and building and performance standards adopted by the commission under Section 430.001.

(9) "Nonstructural matter" has the meaning assigned by the limited statutory warranty and building and performance standards adopted by the commission under Section 430.001.

(10) "Request" means a request submitted under Section 428.001.

(11) "State inspector" means a person employed by the commission under Section 427.002.

(12) "State-sponsored inspection and dispute resolution process" means the process by which the commission resolves a request.

(13) "Structural" means the load-bearing portion of a home.

(14) "Structural failure" has the meaning assigned by the limited statutory warranty and building and performance standards adopted by the commission under Section 430.001.

(15) "Third-party inspector" means a person appointed by the commission under Section 428.003.

(16) "Warranty of habitability" means a builder's obligation to construct a home or home improvement that is in compliance with the limited statutory warranties and building and performance standards adopted by the commission under Section 430.001 and that is safe, sanitary, and fit for humans to inhabit.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 401.003. DEFINITION OF BUILDER. (a) In this title, "builder" means any business entity or individual who, for a fixed price, commission, fee, wage, or other compensation, constructs or supervises or manages the construction of:

(1) a new home;

(2) a material improvement to a home, other than an improvement solely to replace or repair a roof of an existing home;

or

(3) an improvement to the interior of an existing home when the cost of the work exceeds $20,000.

(b) The term includes:

(1) an owner, officer, director, shareholder, partner, affiliate, or employee of the builder;

(2) a risk retention group governed by Article 21.54, Insurance Code, that insures all or any part of a builder's liability for the cost to repair a residential construction defect; and

(3) a third-party warranty company and its administrator.

(c) The term does not include any business entity or individual who has been issued a license by this state or an agency or political subdivision of this state to practice a trade or profession related to or affiliated with residential construction if the work being done by the entity or individual to the home is solely for the purpose for which the license was issued.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 401.004. DEFINITION OF CONSTRUCTION DEFECT. (a) In this title, "construction defect" means:

(1) the failure of the design, construction, or repair of a home, an alteration of or a repair, addition, or improvement to an existing home, or an appurtenance to a home to meet the applicable warranty and building and performance standards during the applicable warranty period; and

(2) any physical damage to the home, an appurtenance to the home, or real property on which the home or appurtenance is affixed that is proximately caused by that failure.

(b) The term does not include a defect that arises or any damages that arise wholly or partly from:

(1) the negligence of a person other than the builder or an agent, employee, subcontractor, or supplier of the builder;

(2) failure of a person other than the builder or an agent, employee, subcontractor, or supplier of the builder to:

(A) take reasonable action to mitigate any

damages that arise from a defect; or

(B) take reasonable action to maintain the home;

(3) normal wear, tear, or deterioration; or

(4) normal shrinkage due to drying or settlement of construction components within the tolerance of building and performance standards.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 401.005. EXEMPTIONS. (a) This title does not apply to a home that is:

(1) built by the individual who owns the home, alone or with the assistance of the individual's employees or independent contractors; and

(2) used by the individual as the individual's primary residence for at least one year after the completion or substantial completion of construction of the home.

(b) This title does not apply to a homeowner or to a homeowner's real estate broker, agent, or property manager who supervises or arranges for the construction of an improvement to a home owned by the homeowner.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 401.006. SUNSET PROVISION. The Texas Residential Construction Commission is subject to Chapter 325, Government Code (Texas Sunset Act). Unless continued in existence as provided by that chapter, the commission is abolished and this title expires September 1, 2009.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

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SUBTITLE B. TEXAS RESIDENTIAL CONSTRUCTION COMMISSION

CHAPTER 406. COMMISSION

Sec. 406.001. TEXAS RESIDENTIAL CONSTRUCTION COMMISSION; MEMBERSHIP. (a) The Texas Residential Construction Commission consists of nine members appointed by the governor with the advice and consent of the senate as follows:

(1) four members must be builders who each hold a certificate of registration under Chapter 416;

(2) three members must be representatives of the general public;

(3) one member must be a licensed professional engineer who practices in the area of residential construction; and

(4) one member must be either a licensed architect who practices in the area of residential construction or a building inspector who meets the requirements set forth in Chapter 427 and practices in the area of residential construction.

(b) Appointments to the commission shall be made without regard to the race, color, disability, sex, religion, age, or national origin of the appointees.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 406.002. TERMS. (a) Commission members serve staggered six-year terms, with three members' terms expiring February 1 of each odd-numbered year. The terms of three of the builder representatives must expire in different odd-numbered years. The term of one of the representatives of the general public must expire in each odd-numbered year.

(b) A member of the commission may not serve more than two complete terms.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 406.003. PRESIDING OFFICER. The governor shall designate a member of the commission as the presiding officer of the commission to serve in that capacity at the pleasure of the governor. At a regular meeting in February of each year, the

commission shall elect from its membership a vice presiding officer and a secretary.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 406.004. MEMBERSHIP AND EMPLOYEE RESTRICTIONS. (a) In this section, "Texas trade association" means a cooperative and voluntarily joined association of business or professional competitors in this state designed to assist its members and their industry or profession as a whole in dealing with mutual business or professional problems, issues, and circumstances and in promoting the common interest of its members and their industry and profession as a whole.

(b) A person may not be a member of the commission and may not be a commission employee employed in a "bona fide executive, administrative, or professional capacity," as that phrase is used for purposes of establishing an exemption to the overtime provisions of the federal Fair Labor Standards Act of 1938 (29 U.S.C. Section 201 et seq.) and its subsequent amendments, if:

(1) the person is an employee or paid consultant of a Texas trade association in the field of residential construction; or

(2) the person's spouse is a manager or paid consultant of a Texas trade association in the field of residential construction.

(c) A person may not be a member of the commission or act as the general counsel to the commission if the person is required to register as a lobbyist under Chapter 305, Government Code, because of the person's activities for compensation on behalf of a profession related to the operation of the commission.

(d) A person may not be a commission employee described by Subsection (b) if the person is an employee or agent in the field of residential construction. This subsection does not apply to a person appointed to the commission.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 406.005. GROUNDS FOR REMOVAL. (a) It is a ground for removal from the commission that a member:

(1) does not have at the time of taking office the qualifications required by Section 406.001;

(2) does not maintain during service on the commission the qualifications required by Section 406.001;

(3) is ineligible for membership under Section 406.004;

(4) cannot because of illness or disability discharge the member's duties for a substantial part of the member's term; or

(5) is absent from more than half of the regularly scheduled commission meetings that the member is eligible to attend during a calendar year without an excuse approved by a majority vote of the commission.

(b) The validity of an action of the commission is not affected by the fact that it is taken when a ground for removal of a commission member exists.

(c) If the executive director has knowledge that a potential ground for removal exists, the executive director shall notify the presiding officer of the potential ground. The presiding officer shall then notify the governor and the attorney general that a potential ground for removal exists. If the potential ground for removal involves the presiding officer, the executive director shall notify the next highest ranking officer of the commission, who shall notify the governor and the attorney general that a potential ground for removal exists.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 406.006. TRAINING. (a) A person who is appointed to and qualifies for office as a member of the commission may not vote, deliberate, or be counted as a member in attendance at a meeting of the commission until the person completes a training program that complies with this section.

(b) The training program must provide the person with information regarding:

(1) the legislation that created the commission;

(2) the programs operated by the commission;

(3) the role and functions of the commission;

(4) the rules of the commission, with an emphasis on

the rules that relate to disciplinary and investigatory authority;

(5) the current budget for the commission;

(6) the results of the most recent formal audit of the commission;

(7) the requirements of:

(A) the open meetings law, Chapter 551, Government Code;

(B) the public information law, Chapter 552, Government Code;

(C) the administrative procedure law, Chapter 2001, Government Code; and

(D) other laws relating to public officials, including conflict-of-interest laws; and

(8) any applicable ethics policies adopted by the commission or the Texas Ethics Commission.

(c) A person appointed to the commission is entitled to reimbursement, as provided by the General Appropriations Act, for the travel expenses incurred in attending the training program regardless of whether the attendance at the program occurs before or after the person qualifies for office.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 406.007. MEETINGS. The commission shall meet at least quarterly and at other times at the call of the presiding officer.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

CHAPTER 407. EXECUTIVE DIRECTOR AND OTHER AGENCY PERSONNEL

Sec. 407.001. EXECUTIVE DIRECTOR. The commission shall employ an executive director as the executive head of the agency.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 407.002. OTHER PERSONNEL. The commission may employ other personnel as necessary for the administration of this title.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 407.003. DIVISION OF RESPONSIBILITIES. The commission shall develop and implement policies that clearly separate the policy-making responsibilities of the commission and the management responsibilities of the executive director and the staff of the commission.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 407.004. QUALIFICATIONS AND STANDARDS OF CONDUCT INFORMATION. The executive director or the executive director's designee shall provide to members of the commission and to commission employees, as often as necessary, information regarding the requirements for office or employment under this title, including information regarding a person's responsibilities under applicable laws relating to standards of conduct for state officers or employees.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 407.005. CAREER LADDER PROGRAM; PERFORMANCE EVALUATION. (a) The executive director or the executive director's designee shall develop an intra-agency career ladder program that addresses opportunities for mobility and advancement for employees within the commission. The program must require intra-agency posting of all nonentry level positions concurrently with any public posting.

(b) The executive director or the executive director's designee shall develop a system of annual performance evaluations based on measurable job tasks. All merit pay for commission

employees must be based on the system established under this subsection.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 407.006. EQUAL EMPLOYMENT OPPORTUNITY POLICY; ANNUAL REPORT. (a) The executive director or the executive director's designee shall prepare and maintain a written policy statement that implements a program of equal employment opportunity to ensure that all personnel decisions are made without regard to race, color, disability, sex, religion, age, or national origin.

(b) The policy statement must include:

(1) personnel policies, including policies relating to recruitment, evaluation, selection, training, and promotion of personnel, that show the intent of the commission to avoid the unlawful employment practices described by Chapter 21, Labor Code; and

(2) an analysis of the extent to which the composition of the commission's personnel is in accordance with state and federal law and a description of reasonable methods to achieve compliance with state and federal law.

(c) The policy statement must:

(1) be updated annually;

(2) be reviewed by the state Commission on Human Rights for compliance with Subsection (b)(1); and

(3) be filed with the governor's office.

(d) The governor's office shall deliver a biennial report to the legislature based on the information received under Subsection (c)(3). The report may be made separately or as a part of other biennial reports made to the legislature.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 407.007. INFORMATION AND TRAINING ON STATE EMPLOYEE INCENTIVE PROGRAM. The executive director or the executive director's designee shall provide to commission employees information and training on the benefits and methods of participation in the state employee incentive program.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1,

PROPERTY CODE

CHAPTER 408. POWERS AND DUTIES

Sec. 408.001. RULES. The commission shall adopt rules as necessary for the implementation of this title, including rules:

(1) governing the state-sponsored inspection and dispute resolution process, including building and performance standards, administrative regulations, and the conduct of hearings under Subtitle D;

(2) establishing limited statutory warranty and building and performance standards for residential construction;

(3) approving third-party warranty companies; and

(4) approving third-party inspectors.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 408.002. FEES. The commission shall adopt fees as required by this title in amounts that are reasonable and necessary to provide sufficient revenue to cover the costs of administering this title.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 408.003. ACCESSIBILITY. (a) The commission shall comply with federal and state laws related to program and facility accessibility.

(b) The executive director shall prepare and maintain a written plan that describes how a person who does not speak English can obtain reasonable access to the commission's programs and services.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 408.004. ANNUAL REPORT. (a) The commission shall file annually with the governor and the presiding officer of each house of the legislature a complete and detailed written report accounting for all funds received and disbursed by the commission during the preceding fiscal year.

(b) The report must be in the form and reported in the time provided by the General Appropriations Act.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1,

CHAPTER 409. PUBLIC INTEREST INFORMATION AND COMPLAINT PROCEDURES

Sec. 409.001. PUBLIC INTEREST INFORMATION. (a) The commission shall prepare information of public interest describing the functions of the commission, the provisions of the limited statutory warranty and building and performance standards, the state-sponsored inspection and dispute resolution process, and the procedures by which complaints or requests are filed with and resolved by the commission.

(b) The commission shall make the information available to the public and appropriate state agencies and shall post the information on the commission's website.

(c) Within 30 days of the receipt by the commission of the registration required by Section 426.003, the commission shall mail a copy of the information of public interest described in Subsection (a) to the owner of the home as described in the registration.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 409.002. PUBLIC PARTICIPATION. The commission shall develop and implement policies that provide the public with a reasonable opportunity to appear before the commission and to speak on any issue under the jurisdiction of the commission.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 409.003. RECORDS OF COMPLAINTS. (a) The commission shall maintain a file on each written complaint filed with the commission.

(b) The commission shall provide to the person filing the complaint and to each person who is a subject of the complaint a copy of the commission's policies and procedures relating to complaint investigation and resolution.

(c) The commission, at least quarterly until final disposition of the complaint, shall notify the person filing the complaint and each person who is a subject of the complaint of the status of the investigation.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1,

PROPERTY CODE

SUBTITLE C. BUILDER REGISTRATION

CHAPTER 416. CERTIFICATE OF REGISTRATION

Sec. 416.001. REGISTRATION REQUIRED. A person may not act as a builder unless the person holds a certificate of registration under this chapter.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.002. APPLICATION FOR CERTIFICATE. (a) An applicant for an original or renewal certificate of registration must submit an application on a form prescribed by the commission.

(b) Each applicant must disclose in the application whether the applicant has:

(1) entered a plea of guilty or nolo contendere to a felony charge or a misdemeanor involving moral turpitude; or

(2) been convicted of a felony or a misdemeanor involving moral turpitude and the time for appeal has elapsed or the conviction has been affirmed on appeal.

(c) Disclosure under Subsection (b) is required regardless of whether an order granting the person community supervision suspended the imposition of the sentence.

(d) The commission may, on receipt of an application, conduct a criminal background check of the applicant or any person responsible for the application. The commission may obtain criminal history record information maintained by the Department of Public Safety, the Federal Bureau of Investigation, or any other local, state, or national governmental entity. Unless the information is a public record at the time the commission obtains the information under this subsection, the information is confidential, and the commission may not release or disclose the information to any person except under a court order or with the permission of the applicant.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.003. PROVISIONAL REGISTRATION. (a) Pending the receipt of the results of a criminal background check, the commission may issue a provisional registration certificate. On

approval of the results of the criminal background check, the commission shall issue a registration certificate. On receipt of unfavorable results of the criminal background check, the commission shall revoke the provisional registration certificate.

(b) This section expires January 1, 2005.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.004. FEES. (a) The commission shall charge and collect:

(1) a filing fee for an application for an original certificate of registration that does not exceed $500; and

(2) a fee for renewal of a certificate of registration that does not exceed $300.

(b) The commission shall establish a fee schedule that takes into consideration the unit volume or dollar volume of potential applicants.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.005. GENERAL ELIGIBILITY REQUIREMENTS. A person may not receive a certificate of registration under this chapter unless:

(1) the person, at the time of the application:

(A) is at least 18 years of age; and

(B) is a citizen of the United States or a lawfully admitted alien; and

(2) the commission is satisfied with the person's honesty, trustworthiness, and integrity based on information supplied or discovered in connection with the person's application.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.006. ADDITIONAL ELIGIBILITY REQUIREMENTS FOR BUSINESS ENTITIES. (a) To be eligible for an original or renewal certificate of registration under this chapter:

(1) a corporation must designate one of its officers as its agent for the purposes of this chapter;

(2) a limited liability company must designate one of its managers as its agent for the purposes of this chapter; and

(3) a partnership, limited partnership, or limited liability partnership must designate one of its managing partners as its agent for the purposes of this chapter.

(b) A corporation, limited liability company, partnership, limited partnership, or limited liability partnership is not eligible to be registered under this chapter and may not act as a builder unless the entity's designated agent is individually registered as a builder.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.007. ISSUANCE OF CERTIFICATE. (a) Not later than the 15th day after the date the commission receives an application from an applicant who meets the requirements of this chapter, the commission shall issue a certificate of registration to the applicant.

(b) The certificate of registration remains in effect for the period prescribed by the commission if the certificate holder complies with this chapter and pays the appropriate renewal fees.

(c) The commission shall issue one certificate of registration for each business entity registered under this chapter.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.008. DENIAL OF REGISTRATION. (a) If the commission denies an application for an original certificate of registration or a renewal application, the commission shall give written notice to the applicant not later than the 15th day after the date the commission receives the application.

(b) The applicant may appeal the denial of the application if, on or before the 30th day after the date the applicant receives notice under this section, the applicant files a written request for a hearing before the commission.

(c) The commission shall:

(1) set a time and place for the hearing not later than the 30th day after the date the commission receives the notice of the appeal; and

(2) give notice of the hearing to the applicant before

the 15th day before the date of the hearing.

(d) The hearing may be continued from time to time with the consent of the applicant.

(e) The hearing shall be before a hearings officer appointed by the commission. After the hearing, the hearings officer shall enter an appropriate order. The order of the hearings officer under this subsection is a final decision.

(f) The commission shall adopt procedural rules under which a decision by a hearings officer under this section is subject to appeal to the commission.

(g) A hearing under this section is governed by Chapter 2001, Government Code.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.009. EXPIRATION OF CERTIFICATE. (a) The commission may issue or renew a certificate of registration for a period that does not exceed 24 months.

(b) The commission by rule may adopt a system under which certificates of registration expire on several dates during the year. The commission shall adjust the date for payment of renewal fees accordingly.

(c) In a year in which the expiration date for a certificate of registration is changed, the renewal fee payable shall be prorated on a monthly basis so that the certificate holder pays only that portion of the fee that is allocable to the number of months during which the certificate of registration is valid. On renewal of the certificate of registration on the new expiration date, the total renewal fee is payable.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.010. OFFICE LOCATION; CHANGE OF ADDRESS; ASSUMED NAMES. (a) A builder shall maintain a fixed office location in this state. The address of the builder's principal place of business must be designated on the certificate of registration.

(b) Not later than the 30th day after the date a builder moves from the address designated on the certificate of registration, the builder shall submit an application, accompanied

by the appropriate fee, for a certificate of registration that designates the new location of the builder's principal place of business. The commission shall issue a certificate of registration that designates the new location if the new location complies with the requirements of this section.

(c) If a builder operates under any name other than the name that is set forth on the builder's certificate of registration, the builder shall, within 45 days of operating under this other name, disclose this other name to the commission.

(d) This section does not require a builder to obtain a certificate of registration for each sales office.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 416.011. TEXAS STAR BUILDER DESIGNATION. (a) The commission shall establish rules and procedures for a program through which a builder can be designated as a "Texas Star Builder." A builder's participation in the program is voluntary and is not a requirement for the issuance of a certificate of registration required under this chapter.

(b) A builder who participates in this program will be allowed to represent to the public that the builder is a "Texas Star Builder" and meets all of the requirements and qualifications that are set forth by the commission for the program.

(c) If the commission determines that a builder must meet certain education requirements to participate in the "Texas Star Builder" program, a builder may satisfy those requirements by completing education programs offered by a trade association or other organization whose education programs have been approved by the commission.

(d) The certification issued by the commission as a "Texas Star Builder" shall be for the same period of time as the builder's registration under this chapter.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

CHAPTER 417. CERTIFICATION OF RESIDENTIAL CONSTRUCTION ARBITRATORS

Sec. 417.001. CERTIFICATION. (a) The commission by rule shall establish eligibility requirements and procedures for a person to be certified by the commission as a residential construction arbitrator.

(b) The requirements established under this section must, at a minimum, require a certified arbitrator to:

(1) have at least five years' experience in conducting arbitrations between homeowners and builders involving construction defects;

(2) be familiar with the statutory warranties and building and performance standards established under Chapter 430 and with the provisions of Chapter 27; and

(3) meet continuing education requirements established by the commission.

(c) Nothing in the chapter prohibits an arbitrator who does not hold a certificate under this chapter from conducting an arbitration involving a residential construction defect.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 417.002. APPLICATION FOR CERTIFICATION. An applicant for certification under this chapter or for renewal of that certification must submit an application on a form prescribed by the commission and include the fee required by Section 417.003.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 417.003. FEES. The commission shall charge and collect:

(1) a filing fee for an application for certification under this chapter that does not exceed $100; and

(2) a fee for renewal of a certification under this chapter that does not exceed $50.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 417.004. PUBLICATION AND COMMENT PERIOD; CERTIFICATION. (a) The commission shall publish notice of each

applicant's original application for certification under this chapter in the Texas Register and allow public comment on the application during the 21 days after the date the notice is published. During that period, any person may contest the application in writing submitted to the commission.

(b) If the commission finds that certification of the applicant is in the public interest, the commission shall certify the applicant under this chapter.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 417.005. DENIAL OF CERTIFICATION. The commission shall establish procedures under which a denial of a certification under this chapter may be contested by the applicant.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 417.006. EXPIRATION OF CERTIFICATION. The commission may issue or renew a certification under this chapter for a period that does not exceed 24 months.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 417.007. LIST OF CERTIFIED ARBITRATORS. The commission shall maintain an updated list of residential construction arbitrators certified under this chapter and make the list available to the public.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

CHAPTER 418. PROHIBITED PRACTICES; DISCIPLINARY PROCEEDINGS

Sec. 418.001. GROUNDS FOR DISCIPLINARY ACTION. A person is subject to disciplinary action under this chapter for:

(1) fraud or deceit in obtaining a registration or certification under this subtitle;

(2) misappropriation of trust funds in the practice of residential construction;

(3) naming false consideration in a contract to sell a new home or in a construction contract;

(4) discriminating on the basis of race, color, religion, sex, national origin, or ancestry;

(5) publishing a false or misleading advertisement;

(6) failure to honor, within a reasonable time, a check issued to the commission after the commission has sent by certified mail a request for payment to the person's last known business address, according to commission records;

(7) failure to pay an administrative penalty assessed by the commission under Chapter 419;

(8) nonpayment of a final nonappealable judgment arising from a construction defect or other transaction between the person and a homeowner;

(9) failure to register a home as required by Section 426.003;

(10) failure to remit the fee for registration of a home under Section 426.003; or

(11) failure to reimburse a homeowner the amount ordered by the commission as provided in Section 428.004(d).

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 418.002. DISCIPLINARY POWERS OF COMMISSION. On a determination that a ground for disciplinary action under Section 418.001 exists, the commission may:

(1) revoke or suspend a registration or certification;

(2) probate the suspension of a registration or certification; or

(3) formally or informally reprimand a registered or

certified person.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 418.003. HEARING. (a) If the commission proposes to take a disciplinary action against a person under Section 418.002, the person is entitled to a hearing before the commission.

(b) The commission shall adopt procedural rules by which all decisions to take disciplinary action under this chapter are subject to appeal to the commission.

(c) The commission shall prescribe the time and place of the hearing.

(d) A hearing under this section is governed by Chapter 2001, Government Code.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 418.004. APPEAL. (a) A person aggrieved by a ruling, order, or decision of the commission is entitled to appeal to a district court in the county in which the administrative hearing was held.

(b) An appeal under this section is governed by Chapter 2001, Government Code.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

CHAPTER 419. ADMINISTRATIVE PENALTY

Sec. 419.001. IMPOSITION OF ADMINISTRATIVE PENALTY. In a contested case involving disciplinary action, the commission may, as part of the commission's order, impose an administrative penalty on a registered or certified person who violates this title or a rule adopted or order issued by the commission under this title.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 419.002. AMOUNT OF PENALTY. (a) An administrative penalty imposed under this chapter may not exceed $5,000 for each violation.

(b) In determining the amount of an administrative penalty, the hearings officer or commission shall consider:

(1) the seriousness of the violation, including the nature, circumstances, extent, and gravity of the prohibited acts;

(2) the history of previous violations;

(3) the amount necessary to deter a future violation;

(4) efforts to correct the violation; and

(5) any other matter justice may require.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 419.003. PAYMENT OF PENALTY. The commission shall specify in an order imposing an administrative penalty under this chapter a date on or before the 30th day after the date the order becomes final and unappealable by which the person against whom the penalty is imposed must pay the penalty.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 419.004. ENFORCEMENT OF PENALTY. If a person does not pay an administrative penalty imposed under this chapter and enforcement of the penalty is not stayed, the commission may:

(1) refer the matter to the attorney general for collection of the penalty; or

(2) enforce any part of the order that specifies disciplinary action to be taken against the registered or certified person if the registered or certified person fails to pay the

administrative penalty within the time prescribed.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

SUBTITLE D. STATE-SPONSORED INSPECTION AND DISPUTE RESOLUTION PROCESS; STATUTORY WARRANTY AND BUILDING AND PERFORMANCE STANDARDS

CHAPTER 426. GENERAL PROVISIONS

Sec. 426.001. APPLICABILITY OF SUBTITLE. (a) This subtitle applies to a dispute between a builder and a homeowner if:

(1) the dispute arises out of an alleged construction defect, other than a claim solely for:

(A) personal injury, survival, or wrongful death; or

(B) damage to goods; and

(2) a request is submitted to the commission on or before the 10th anniversary of the date of the initial transfer of title from the builder to the initial owner of the home or the improvement that is the subject of the dispute or, if there is not a closing, the date on which the contract for construction of the improvement was entered into.

(b) This subtitle does not apply to a dispute arising out of:

(1) an alleged violation of Section 27.01, Business & Commerce Code;

(2) a builder's wrongful abandonment of an improvement project before completion; or

(3) a violation of Chapter 162.

(c) For the purposes of this section, "damage to goods" does not include damage to a home.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 426.002. CONFLICT WITH CERTAIN OTHER LAW. To the extent of any conflict between this subtitle and any other law, including Chapter 27 and the Deceptive Trade Practices-Consumer Protection Act (Subchapter E, Chapter 17, Business & Commerce Code), this subtitle prevails.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 426.003. REGISTRATION OF HOME. (a) A builder shall register a new home with the commission on or before the 15th day of

the month following the month in which the transfer of title from the builder to the homeowner occurs. The registration must include the information required by the commission by rule and be accompanied by the fee required by Subsection (c).

(b) A builder who enters into a transaction governed by this title, other than the transfer of title of a new home from the builder to the seller, shall register the home involved in the transaction with the commission. The registration must:

(1) include the information required by the commission by rule;

(2) be accompanied by the fee required by Subsection (c); and

(3) be delivered to the commission not later than the 15th day after the earlier of:

(A) the date of the agreement that describes the transaction between the homeowner and the builder; or

(B) the commencement of the work on the home.

(c) A builder must remit to the commission a registration fee for each home registered with the commission in an amount determined by the commission. The fee set by the commission under this subsection may not exceed $125.

(d) The commission may assess a late payment penalty that does not exceed $500 against a builder who fails to pay a required registration fee in the time prescribed by this section.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 426.004. FEES. (a) A party who submits a request under this subtitle shall pay any amount required by the commission to cover the expense of the third-party inspector.

(b) The commission shall adopt rules permitting a waiver or reduction of the inspection expenses for homeowners demonstrating a financial inability to pay the expenses.

(c) If the transfer of the title of the home from the builder to the initial homeowner occurred before January 1, 2004, or if the contract for improvements or additions between the builder and homeowner was entered into before January 1, 2004, the person who submits a request involving the home shall pay, in addition to the

inspection expenses required by this section, the registration fee required by Section 426.003.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 426.005. PREREQUISITE TO ACTION. (a) A homeowner must comply with this subtitle before initiating an action for damages or other relief arising from an alleged construction defect.

(b) An action described by Subsection (a) must be filed:

(1) on or before the expiration of any applicable statute of limitations or by the 45th day after the date the third-party inspector issues the inspector's recommendation, whichever is later; or

(2) if the recommendation is appealed, on or before the expiration of any applicable statute of limitations or by the 45th day after the date the commission issues its ruling on the appeal, whichever is later.

(c) Any claim for personal injuries, damages to personal goods, or consequential damages or other relief arising out of an alleged construction defect must be included in any action concerning the construction defect.

(d) This section does not apply to an action that is initiated by a person subrogated to the rights of a claimant if payment was made pursuant to a claim made under an insurance policy.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 426.006. TIME FOR REQUESTING INSPECTION AND DISPUTE RESOLUTION. The state-sponsored inspection and dispute resolution process must be requested on or before the second anniversary of the date of discovery of the conditions claimed to be evidence of the construction defect but not later than the 30th day after the date the applicable warranty period expires.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 426.007. ADMISSIBILITY OF CERTAIN EVIDENCE. A person who submits a request for state-sponsored inspection and dispute resolution must disclose in the request the name of any person who,

before the request is submitted, inspected the home on behalf of the requestor in connection with the construction defect alleged in the request. If a person's name is known to the requestor at the time of the request and is not disclosed as required by this section, the requestor may not designate the person as an expert or use materials prepared by that person in:

(1) the state-sponsored inspection and dispute resolution process arising out of the request; or

(2) any action arising out of the construction defect that is the subject of the request.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 426.008. REBUTTABLE PRESUMPTION OF THIRD-PARTY INSPECTOR'S RECOMMENDATION OR RULING BY PANEL OF STATE INSPECTORS. (a) In any action involving a construction defect brought after a recommendation by a third-party inspector or ruling by a panel of state inspectors on the existence of the construction defect or its appropriate repair, the recommendation or ruling shall constitute a rebuttable presumption of the existence or nonexistence of a construction defect or the reasonable manner of repair of the construction defect. A party seeking to dispute, vacate, or overcome that presumption must establish by a preponderance of the evidence that the recommendation or ruling is inconsistent with the applicable warranty and building and performance standards.

(b) The presumption established by this section applies only to an action between the homeowner and the builder. A recommendation or ruling under this subtitle is not admissible in an action between any other parties.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

CHAPTER 427. INSPECTORS

Sec. 427.001. QUALIFICATIONS OF THIRD-PARTY INSPECTORS. (a) A third- party inspector approved by the commission must:

(1) meet the minimum qualifications prescribed by this section and any other qualifications prescribed by the commission by rule; and

(2) submit an application to the commission annually with an application fee in the amount required by the commission by rule.

(b) A third-party inspector who inspects an issue involving workmanship and materials must:

(1) have a minimum of five years' experience in the residential construction industry; and

(2) be certified as a residential combination inspector by the International Code Council.

(c) A third-party inspector who inspects an issue involving a structural matter must:

(1) be an approved structural engineer or approved architect; and

(2) have a minimum of 10 years' experience in residential construction.

(d) Each third-party inspector who inspects an issue involving a structural matter must receive, in accordance with commission rules:

(1) initial training regarding the state-sponsored inspection and dispute resolution process and this subtitle; and

(2) annual continuing education in the inspector's area of practice.

(e) A third-party inspector may not receive more than 10 percent of the inspector's gross income in a federal income tax year from providing expert witness services, including retention for the purpose of providing testimony, evidence, or consultation in connection with a pending or threatened legal action.

(f) In adopting rules under Subsection (d), the commission shall recognize any continuing education requirements established

for engineers and architects.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 427.002. STATE INSPECTORS. (a) The commission shall employ state inspectors to:

(1) review on an appeals panel the recommendations of third-party inspectors;

(2) provide consultation to third-party inspectors; and

(3) administer the state-sponsored inspection and dispute resolution process.

(b) A state inspector must be certified as a residential combination inspector by the International Code Council.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

CHAPTER 428. STATE-SPONSORED INSPECTION AND DISPUTE RESOLUTION PROCESS

Sec. 428.001. REQUEST FOR RESOLUTION. (a) If a dispute between a homeowner and a builder arises out of an alleged construction defect, the homeowner or the builder may submit to the commission a written request for state-sponsored inspection and dispute resolution.

(b) The request must:

(1) specify in reasonable detail each alleged construction defect that is a subject of the request;

(2) state the amount of any known out-of-pocket expenses and engineering or consulting fees incurred by the homeowner in connection with each alleged construction defect;

(3) include any evidence that depicts the nature and cause of each alleged construction defect and the nature and extent of repairs necessary to remedy the construction defect, including, if available, expert reports, photographs, and videotapes, if that evidence would be discoverable under Rule 192, Texas Rules of Civil Procedure;

(4) be accompanied by the fees required under Section 426.004; and

(5) state the name of any person who has, on behalf of the requestor, inspected the home in connection with an alleged construction defect.

(c) Not later than the 30th day before the date a homeowner submits a request under this section, the homeowner must notify the builder in writing of each construction defect the homeowner claims to exist. After the notice is provided, the builder must be provided with a reasonable opportunity to inspect the home or have the builder's designated consultants inspect the home.

(d) A person who submits a request under this section must send by certified mail, return receipt requested, a copy of the request, including evidence submitted with the request, to each other party involved in the dispute.

(e) The commission by rule shall establish methods by which homeowners may be notified of the name, mailing address, and

telephone number of the commission for the purpose of directing a request to the commission.

(f) The commission shall provide a person who files a request with a copy of the commission's policies and procedures relating to investigation and resolution of a request.

(g) The commission by rule shall establish a standard form for submitting a request under this section and provide a means to submit a request electronically.

(h) The filing of a request under this section tolls the limitations period in any action between the homeowner and the builder arising out of the subject of the request until the 45th day after the date a final, nonappealable recommendation is issued under this title in response to the request.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 428.002. BUILDER'S RIGHT OF INSPECTION. (a) In addition to the right of inspection provided by Section 428.001(c), at any time before the conclusion of the state-sponsored inspection and dispute resolution process and on the builder's written request, the builder shall be given reasonable opportunity to inspect the home that is the subject of the request or have the home inspected to determine the nature and cause of the construction defect and the nature and extent of repairs necessary to remedy the construction defect.

(b) The builder may take reasonable steps to document the construction defect and the condition of the home.

(c) If the homeowner delays the inspection for more than five days after the date of receiving the builder's written request, any period for subsequent action to be taken by the builder or the third-party inspector shall be extended one day for each day the inspection is delayed after the fifth day.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 428.003. INSPECTION BY THIRD-PARTY INSPECTOR. (a) On or before the 15th day after the date the commission receives a request, the commission shall appoint the next available third-party inspector from the applicable lists of

third-party inspectors maintained by the commission under Subsection (c).

(b) The commission shall establish rules and regulations that allow the homeowner and the builder to each have the right to strike the appointment of a third-party inspector one time for each request submitted.

(c) The commission shall adopt rules that allow for the commission to maintain a list of available third-party inspectors for the various regions of the state, as required to satisfy the provisions of this title.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 428.004. INSPECTOR'S RECOMMENDATION. (a) If the dispute involves workmanship and materials in the home of a nonstructural matter, the third-party inspector shall issue a recommendation not later than the 15th day after the date the third-party inspector receives the appointment from the commission.

(b) If the dispute involves a structural matter in the home, the commission shall appoint an approved engineer to be the third-party inspector. The third-party inspector shall inspect the home not later than the 30th day after the date the request is submitted and issue a recommendation not later than the 60th day after the date the third-party inspector receives the assignment from the commission, unless additional time is requested by the third-party inspector or a party to the dispute. The commission shall adopt rules governing the extension of time under this subsection.

(c) The third-party inspector's recommendation must:

(1) address only the construction defect, based on the applicable warranty and building and performance standards; and

(2) designate a method or manner of repair, if any.

(d) Except as provided by this subsection, the third-party inspector's recommendation may not include payment of any monetary consideration. If the inspector finds for the party who submitted the request, the commission may order the other party to reimburse all or part of the fees and inspection expenses paid by the

requestor under Section 426.004.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 428.005. THREAT TO HEALTH OR SAFETY. A builder who receives written notice of a request relating to a construction defect that creates an imminent threat to the health or safety of the inhabitants of the residence shall take reasonable steps to cure the defect as soon as practicable. If the builder fails to cure the defect in a reasonable time, the homeowner may have the defect cured and recover from the builder the reasonable cost of the cure plus reasonable attorney's fees and expenses associated with curing the defect in addition to any other damages not inconsistent with this subtitle.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

CHAPTER 429. APPEAL OF THIRD-PARTY INSPECTOR'S RECOMMENDATION

Sec. 429.001. APPEAL. (a) A homeowner or builder may appeal a third- party inspector's recommendation on or before the 15th day after the date the recommendation is issued.

(b) If a homeowner or builder appeals a third-party inspector's recommendation, the executive director shall appoint three state inspectors to a panel to review the recommendation. If the recommendation involves a dispute regarding a structural failure, one of the state inspectors on the panel must be a licensed professional engineer.

(c) The panel shall:

(1) review the recommendation without a hearing unless a hearing is otherwise required by rules adopted by the commission;

(2) approve, reject, or modify the recommendation of the third-party inspector or remand the dispute for further action by the third-party inspector; and

(3) issue written findings of fact and a ruling on the appeal not later than the 30th day after the date the notice of appeal is filed with the commission.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

CHAPTER 430. WARRANTIES AND BUILDING AND PERFORMANCE STANDARDS

Sec. 430.001. LIMITED STATUTORY WARRANTIES AND BUILDING AND PERFORMANCE STANDARDS. (a) The commission by rule shall adopt limited statutory warranties and building and performance standards for residential construction that comply with this section.

(b) The warranty periods shall be:

(1) one year for workmanship and materials;

(2) two years for plumbing, electrical, heating, and air-conditioning delivery systems; and

(3) 10 years for major structural components of the home.

(c) The limited statutory warranties and building and performance standards must:

(1) require substantial compliance with the nonelectrical standards contained in the version of the International Residential Code for One- and Two-Family Dwellings published by the International Code Council that is applicable under Subsection (d) and the electrical standards contained in the version of the National Electrical Code that is applicable under Subsection (e);

(2) include standards for mold reduction and remediation that comply with Section 430.003;

(3) establish standards for performance for interior and exterior components of a home, including foundations, floors, ceilings, walls, roofs, drainage, landscaping, irrigation, heating, cooling, and electrical and plumbing components; and

(4) contain standards that are not less stringent than the standards required by the United States Department of Housing and Urban Development for FHA programs as set forth in 24 C.F.R. Sections 203.202 through 203.206.

(d) The International Residential Code for One- and Two-Family Dwellings that applies to nonelectrical aspects of residential construction for the purposes of the limited statutory warranties and building and performance standards adopted under this section is:

(1) for residential construction located in a municipality or the extraterritorial jurisdiction of a municipality, the version of the International Residential Code applicable to nonelectrical aspects of residential construction in the municipality under Section 214.212, Local Government Code;

(2) for residential construction located in an unincorporated area not in the extraterritorial jurisdiction of a municipality, the version of the International Residential Code applicable to nonelectrical aspects of residential construction in the municipality that is the county seat of the county in which the construction is located; and

(3) for residential construction located in an unincorporated area in a county that does not contain an incorporated area, the version of the International Residential Code that existed on May 1, 2001.

(e) The National Electrical Code for One- and Two-Family Dwellings that applies to electrical aspects of residential construction for the purposes of this section is:

(1) for residential construction located in a municipality or the extraterritorial jurisdiction of a municipality, the version of the National Electrical Code applicable to electrical aspects of residential construction in the municipality under Section 214.214, Local Government Code;

(2) for residential construction located in an unincorporated area not in the extraterritorial jurisdiction of a municipality, the version of the National Electrical Code applicable to electrical aspects of residential construction in the municipality that is the county seat of the county in which the construction is located; and

(3) for residential construction located in an unincorporated area in a county that does not contain an incorporated area, the version of the National Electrical Code that existed on May 1, 2001.

(f) Except as provided by a written agreement between the builder and the initial homeowner, a warranty period adopted under this section for a new home begins on the earlier of the date of:

(1) occupancy; or

(2) transfer of title from the builder to the initial homeowner.

(g) A warranty period adopted under this section for an improvement other than a new home begins on the date the improvement is substantially completed.

(h) The building and performance standards adopted by the commission under this section may be adopted in phases and amended or supplemented by the commission from time to time as the commission receives additional evidence or information from task forces or other sources regarding any improvements or developments in the areas of residential homebuilding practices, procedures, or technology.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.002. WARRANTY OF HABITABILITY. (a) The construction of each new home or home improvement shall include the warranty of habitability.

(b) For a construction defect to be actionable as a breach of the warranty of habitability, the defect must have a direct adverse effect on the habitable areas of the home and must not have been discoverable by a reasonable prudent inspection or examination of the home or home improvement within the applicable warranty periods adopted by the commission under Section 430.001.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.003. MOLD REDUCTION AND REMEDIATION; TASK FORCE. (a) The building and performance standards adopted under Section 430.001 must include measures that are designed to reduce the general population's exposure to mold often formed in water-damaged building materials and that include:

(1) methods by which mold, water damage, and microbial volatile compounds in indoor environments may be recognized; and

(2) recommended management practices for:

(A) limiting moisture intrusion in a home, which may include the use of a water leak detection system listed by Underwriters Laboratories that is capable of shutting off a valve on the main water line coming into the structure immediately upon

detecting a water leak in the structure; and

(B) mold remediation.

(b) The commission shall appoint a task force to advise the commission with regard to adoption of standards under this section. The task force must include representatives of public health officers of this state, health and medical experts, mold abatement experts, and representatives of affected consumers and industries. The commission and the task force shall consider the feasibility of adopting permissible limits for exposure to mold in indoor environments.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.004. CERTAIN DESIGN RECOMMENDATIONS; ADVISORY COMMITTEE. The commission shall appoint a task force to develop design recommendations for residential construction that encourage rain harvesting and water recycling.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.005. ALTERNATIVE STANDARDS FOR CERTAIN CONSTRUCTION. For the purpose of this title, the only statutory warranty and building and performance standards that apply to residential construction in unincorporated areas of counties that are considered economically distressed areas as defined by Section 15.001(11) of the Water Code and located within 50 miles of an international border are the standards established for colonia housing programs administered by the Texas Department of Housing and Community Affairs, unless a county commissioners court has adopted other building and performance standards authorized by statute.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.006. STATUTORY WARRANTIES EXCLUSIVE. The warranties established under this chapter supersede all implied warranties. The only warranties that exist for residential construction or residential improvements are warranties created by this chapter or by other statutes expressly referring to residential construction or residential improvements, or any

express, written warranty acknowledged by the homeowner and the builder.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.007. WAIVER BY CONTRACT PROHIBITED. A contract between a builder and a homeowner may not waive the limited statutory warranties and building and performance standards adopted under this chapter or the warranty of habitability. This section does not prohibit a builder and a homeowner from contracting for more stringent warranties and building standards than are provided under this chapter.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.008. APPROVAL OF THIRD-PARTY WARRANTY COMPANY. (a) The commission may approve as a third-party warranty company for the purposes of Section 430.009:

(1) an entity that has operated warranty programs in this state for at least five years;

(2) a company whose performance is insured by an insurance company authorized to engage in the business of insurance in this state; or

(3) an insurance company that insures the warranty obligations of a builder under the statutory warranty and building and performance standards.

(b) A third-party warranty company must submit to the commission an annual application and fee in the form and in the amount required by the commission by rule before the company may be approved under this section.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.009. THIRD-PARTY WARRANTY COMPANY. (a) A builder may elect to provide a warranty through a third-party warranty company approved by the commission.

(b) A transfer of liability under this section is not effective unless the company providing the warranty:

(1) agrees to perform the builder's warranty obligations under this chapter that are covered by the warranty

provided through the third-party warranty company; and

(2) actually pays for or corrects any construction defect covered by the warranty provided through the third-party warranty company.

(c) A third-party warranty company approved by the commission has all of the obligations and rights of a builder under this subtitle regarding performance of repairs to remedy construction defects or payment of money instead of repair.

(d) The third-party warranty company may not assume liability for personal injuries or damage to personal property. A builder does not avoid liability for personal injuries or damage to personal property for which the builder would otherwise be liable under law by providing a written warranty from a third-party warranty company.

(e) A company that administers a warranty for a third-party warranty company is not liable for any damages resulting from a construction defect or from repairs covered under the warranty.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.010. MINIMUM STANDARDS FOR DETERMINATION OF DEFECT. A third- party warranty company shall use defect inspection procedures substantially similar to the procedures adopted by the commission under this subtitle. A warranty company may adopt warranty standards in addition to the standards adopted by the commission. A third-party warranty company may not reduce the limited statutory warranty and building and performance standards, except that a third-party warranty company shall not be required to provide a warranty of habitability.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 430.011. EFFECT OF SUBTITLE ON OTHER RIGHTS AND OBLIGATIONS. (a) Except as permitted by this subtitle, an express, written contract between a homeowner and a builder may not limit the obligations of a builder under this title.

(b) After the issuance of written findings of fact and a ruling on an appeal under Chapter 429, a homeowner may bring a cause of action against a builder or third-party warranty company for

breach of a limited statutory warranty adopted by the commission under this subtitle. In an action brought under this subtitle, the homeowner may recover only those damages provided by Section 27.004.

(c) Breach of a limited statutory warranty adopted by the commission or breach of the statutory warranty of habitability shall not, by itself, constitute a violation of the Deceptive Trade Practices-Consumer Protection Act (Subchapter E, Chapter 17, Business & Commerce Code).

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

SUBTITLE E. RESIDENTIAL CONSTRUCTION ARBITRATION

CHAPTER 436. GENERAL PROVISIONS

Sec. 436.001. DEFINITIONS. In this subtitle:

(1) "Arbitration" means the procedure for dispute resolution described by Section 154.027, Civil Practice and Remedies Code.

(2) "Arbitration services provider" means a person that holds itself out as:

(A) managing, coordinating, or administering arbitrations;

(B) providing the services of arbitrators;

(C) making referrals or appointments to arbitrators; or

(D) providing lists of arbitrators.

(3) "Arbitrator" means a neutral individual who hears the claims of the parties to a dispute and renders a decision and who is:

(A) chosen by the parties to the dispute;

(B) appointed by a court; or

(C) selected by an arbitration services provider under an agreement of the parties or applicable rules.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 436.002. APPLICABILITY. (a) This subtitle applies only to an arbitration of a dispute between a homeowner and a builder that involves an alleged construction defect.

(b) The requirements of this subtitle supplement Chapter 171, Civil Practice and Remedies Code, and the Federal Arbitration Act (9 U.S.C. Sections 1-16), as amended.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 436.003. VENUE. (a) An arbitration of a dispute involving a construction defect shall be conducted in the county in which the home alleged to contain the defect is located.

(b) The requirements of this section may not be waived by contract.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 436.004. RESIDENTIAL CONSTRUCTION ARBITRATION TASK FORCE. (a) The commission shall appoint a task force to study residential arbitrators and arbitration and advise the commission with respect to residential arbitrators and arbitration.

(b) The task force established under this section shall report to the 79th and 80th legislatures on the task force's recommendations and the effect of the implementation of those recommendations and of the provisions relating to arbitrators and arbitration in this subtitle. This subsection expires September 1, 2007.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

CHAPTER 437. REPORTING REQUIREMENTS

Sec. 437.001. AWARD FILING. (a) If an arbitration award is filed in a court of competent jurisdiction in this state, the filer shall also, not later than the 30th day after the date an award is made in a residential construction arbitration, file with the commission a summary of the arbitration award that includes:

(1) the names of the parties to the dispute;

(2) the name of each party's attorney, if any;

(3) the name of the arbitrator who conducted the arbitration;

(4) the name of the arbitration services provider who administered the arbitration, if any;

(5) the fee charged to conduct the arbitration;

(6) a general statement of each issue in dispute;

(7) the arbitrator's determination, including the party that prevailed in each issue in dispute and the amount of any monetary award; and

(8) the date of the arbitrator's award.

(b) The commission shall establish rules to permit the voluntary filing of the information listed in Subsection (a) by any interested party. Any agreement prohibiting the disclosure of the information listed in Subsection (a) is unenforceable.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

Sec. 437.002. ENFORCEMENT. (a) The commission by rule shall establish a fee not to exceed $100 for the late filing of an arbitration award and procedures for the collection of that fee.

(b) A party to an arbitration, or an attorney for a party, may report an overdue filing of an arbitration award to the commission.

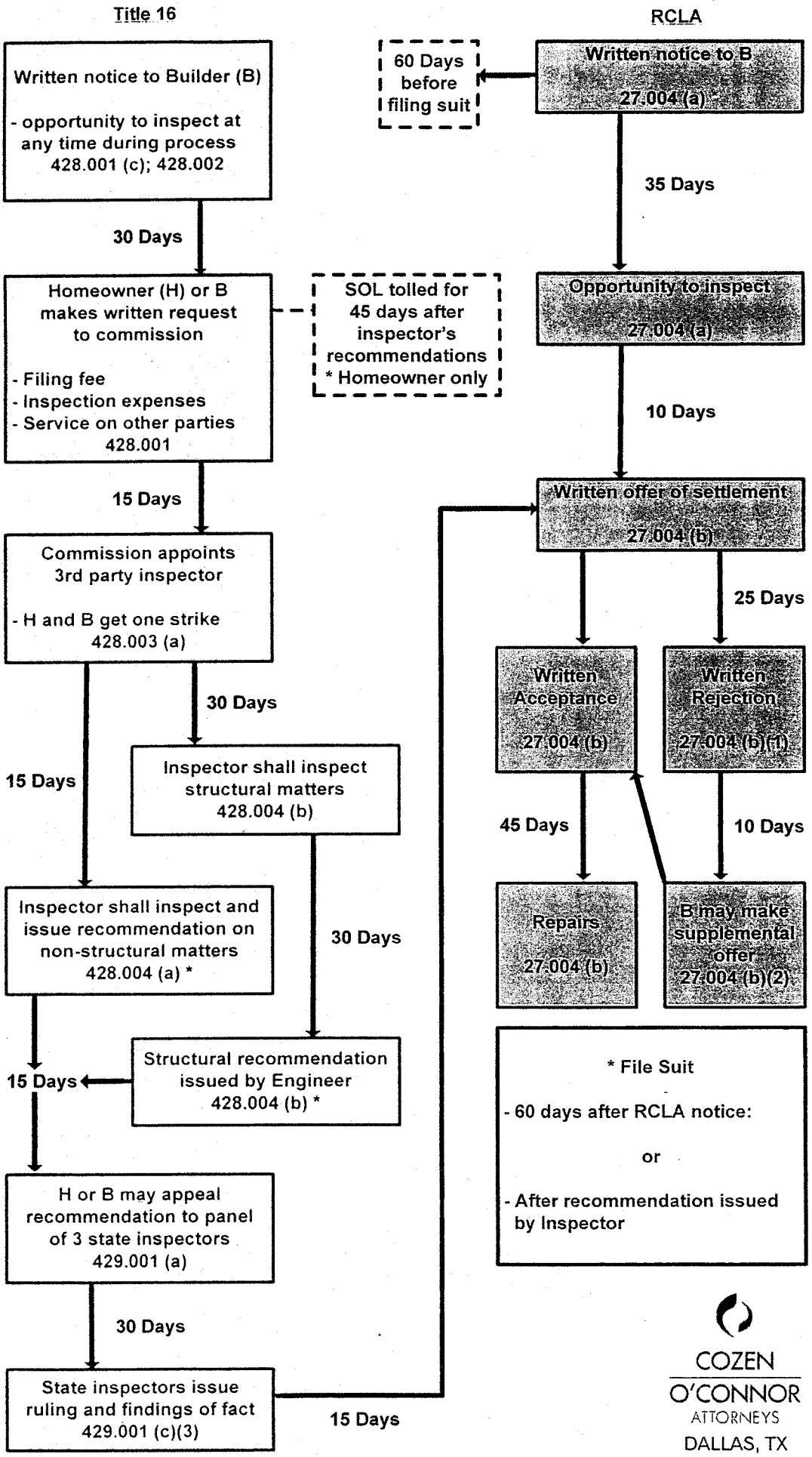
Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.

PROPERTY CODE

CHAPTER 438. ENFORCEABILITY OF RESIDENTIAL CONSTRUCTION ARBITRATION AWARDS

Sec. 438.001. GROUNDS FOR VACATING AWARD. In addition to grounds for vacating an arbitration award under Section 171.088, Civil Practice and Remedies Code, on application of a party, a court shall vacate an award in a residential construction arbitration upon a showing of manifest disregard for Texas law.

Added by Acts 2003, 78th Leg., ch. 458, Sec. 1.01, eff. Sept. 1, 2003.


Title 16
RCLA
Written notice to Builder (B)
- opportunity to inspect at any time during process 428.001 (c); 428.002
60 Days before filing suit
Written notice to B 27.004 (a)
35 Days
30 Days
Homeowner (H) or B makes written request to commission
- Filing fee
- Inspection expenses
- Service on other parties 428.001
SOL tolled for 45 days after inspector's recommendations * Homeowner only
Opportunity to inspect 27.004 (a)
10 Days
15 Days
Written offer of settlement 27.004 (b)
Commission appoints 3rd party inspector
- H and B get one strike 428.003 (a)
25 Days
30 Days
Written Acceptance 27.004 (b)
Written Rejection 27.004 (b)(1)
15 Days
Inspector shall inspect structural matters 428.004 (b)
45 Days
10 Days
Inspector shall inspect and issue recommendation on non-structural matters 428.004 (a) *
30 Days
Repairs 27.004 (b)
B may make supplemental offer 27.004 (b)(2)
Structural recommendation issued by Engineer 428.004 (b) *
15 Days
* File Suit
- 60 days after RCLA notice:
or
- After recommendation issued by Inspector
H or B may appeal recommendation to panel of 3 state inspectors 429.001 (a)
30 Days
State inspectors issue ruling and findings of fact 429.001 (c)(3)
15 Days
COZEN O'CONNOR ATTORNEYS DALLAS, TX

Texas Residential Construction Commission
Quality Construction for Texans

December 9, 2004

VIA Facsimile (214) 462-3299

Cozen O'Connor
1717 Main St., Suite 2300
Dallas, TX 75201

Re:

Dear

Earlier today we spoke by telephone regarding your filing of a request to participate in the state-sponsored inspection and dispute resolution process (SIRP) on behalf of your client Insurance Company as subrogee to the rights of. Pursuant to Property Code §426.005(d) a person subrogated to the rights of a claimant, if payment has been made pursuant to a claim under an insurance policy, is not required to comply with Subtitle D, Title 16, prior to initiating an action for damages or other relief arising from an alleged construction defect. Furthermore, to the extent that there is any conflict between the provisions of Subtitle D and Prop. Code ch. 27, Prop. Code §426.002 provides that Subtitle D prevails. Accordingly, for purposes of reading the 2003 amendments to Property Code ch. 27, Subtitle D, Title 16 does not apply.

Therefore, if Insurance has made a payment under a policy to the for damages arising from an alleged construction defect, it is not necessary to comply with the provisions of Subtitle D.

After you have had an opportunity to assess this, please let us know whether you wish to proceed with the SIRP. If you do not, we will refund any fees that have been paid.

Sincerely,

Susan K. Durso
General Counsel

cc: Stephen D. Thomas, Executive Director
Terry A. Stallings, via facsimile (817) 283-8458

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CHICAGO
DALLAS
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LONDON
LOS ANGELES

COZEN
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ATTORNEYS

NEW YORK
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SAN FRANCISCO
SEATTLE
WASHINGTON, DC
WEST CONSHOHOCKEN
WILMINGTON

A PROFESSIONAL CORPORATION

2300 BANKONE CENTER 1717 MAIN STREET DALLAS, TX 75201-7335
214.462.3000 800.448.1207 214.462.3299 FAX www.cozen.com

NOTICE OF CLAIM PURSUANT TO TEX. PROPERTY CODE § 27.001 ET SEQ. AND §401.001 ET SEQ.

Dear Mr. Builder:

This letter is to inform you that Homeowner Insurance Company ("Carrier") has retained the law firm of Cozen O'Connor in connection with the water damage and subsequent mold contamination that occurred at the above-referenced residence. As a result of payments made and/or to be made pursuant to an insurance policy between Carrier Insurance Company and Harry and Helen Homeowner, Carrier is entitled to assert claims against third parties that are or may be responsible for these damages. Bad Builder was the builder and installer of the pool at the home described above. Our clients are the original owners of the property.

The home has significant water and mold intrusion damage. There is significant leakage from a damaged sewage pipe around the home near the pool area. This caused raw sewage to spill into the ground beneath the home. Given the serious nature of this leakage, the Homeowners were forced to perform emergency repairs to this area. Your work in and around the pool area may have caused or contributed to this damage.

Based upon the foregoing, please allow this letter to place you on notice of a potential claim against Bad Builders, L. P. for the damages caused by your work. Pursuant to the Texas Residential Construction Liability Act (RCLA) and the Texas Residential Construction Commission Act (RCCA), you have thirty-five (35) days upon receipt of this letter to inspect the home and forty-five (45) days to submit a written offer of settlement. However, please be advised that if you do not repair the home within that time period, that we will be forced to file a written request for inspection by the Texas Residential Construction Commission and take any and all appropriate action.

Please contact me to schedule a time to inspect the property.

Please notify your liability insurance carrier of this loss. Because your work and installation may have caused this loss, you and your insurance carrier may have an interest in the investigation of this loss and to inspect the house before it is repaired. Please contact me as soon as possible to let me know if you plan on attending. Additionally, if you are aware of any third parties such as subcontractors that should be notified of this loss, please identify them as soon as possible and forward a copy of this letter to them.

If you fail to make a reasonable offer under the RCLA, RCCA or fail to make a reasonable attempt to repair the damages in a good and workmanlike manner, we will be forced to file suit and seek the reasonable cost necessary to repair the damages, including reasonable and necessary engineering and consulting fees required to evaluate and repair the damages; the reasonable expenses of temporary housing that may be necessary during the repair period; the reduction in market value, if any, to the extent the reduction is due to a structural failure; and reasonable and necessary attorneys' fees.

Thank you for your immediate attention to this matter and please do not hesitate to call me with any questions.

Very truly yours,

COZEN O'CONNOR

JOE ATTORNEY

PHILADELPHIA
ATLANTA
CHARLOTTE
CHERRY HILL
CHICAGO
DALLAS
LAS VEGAS
LONDON
LOS ANGELES

COZEN
O'CONNOR
ATTORNEYS

NEW YORK
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2300 BANKONE CENTER 1717 MAIN STREET DALLAS, TX 75201-7335
214.462.3000 800.448.1207 214.462.3299 FAX www.cozen.com

March 28, 2005

VIA FEDERAL EXPRESS

Texas Residential Construction Commission
311 E. 14th Street, Suite 200
Austin, Texas 78701

Re: State-Sponsored Inspection and Dispute Resolution Process (SIRP)

Dear Sir or Madam:

Enclosed is the State-Sponsored Inspection and Dispute Resolution Process (SIRP) Request Form and a check in the amount of $450.00 to cover filing fees.

Thank you for your attention to this matter. If you have any questions, please do not hesitate to contact me directly.

Sincerely,

COZEN O'CONNOR

By: Joe Attorney

Texas Residential Construction Commission
Quality Construction for Texans

STATE-SPONSORED INSPECTION AND DISPUTE RESOLUTION PROCESS (SIRP) Request Form

Section 1: Address of Home

Street Address _____ City _____ State _____ Zip Code _____ County _____

Section 2: Description of Transaction

Please check the type of transaction giving rise to the dispute, as well as provide the date the transaction occurred and the substantial completion date of construction. A home that is not substantially complete is not eligible for the SIRP. Substantially complete generally means a home or improvement that is fit for occupancy or its intended use.

☐ New home construction on the builder's lot. Date of transfer of title from builder to initial homeowner_____ (MM/DD/YYYY)

☐ New home construction without title transfer. Date of contract or date work began, whichever occurred first: _____ (MM/DD/YYYY)

Date of substantial completion: _____(MM/DD/YYYY)

☐ Material improvement to existing home. Date of contract or date work began, whichever occurred first:_____ (MM/DD/YYYY)

Date of substantial completion: _____(MM/DD/YYYY)

☐ Interior renovation to existing home in excess of $20,000. Date of contract or date work began, whichever occurred first:_____ (MM/DD/YYYY)

Date of substantial completion: _____(MM/DD/YYYY)

Is the current homeowner also the original homeowner? ☐ Yes ☐ No

If the above answer is No, provide the date the current homeowner purchased the home _____(MM/DD/YYYY)

Section 3: Parties Involved

Requestor Information (Person submitting request):

☐ Builder ☐ Homeowner

Name/Company – Contact Person _____

Mailing Address _____

City/State/Zip _____ County _____

Telephone _____ (Day) _____ (Evening) _____

Fax _____ Email _____

Please circle the preferred method of contact:

Legal Counsel Telephone Mail Fax Email

Other Party Involved (Builder or Homeowner):

☐ Builder ☐ Homeowner

Name/Company – Contact Person _____

Mailing Address _____

City/State/Zip _____ County _____

Telephone _____ (Day) _____ (Evening) _____

Fax _____ Email _____

Internal Use Only

Date Approved _____ Builder # _____ Home # _____

SIRP # _____ Type of Inspection _____

SIRP Request Form (Continued)

Section 4: Legal Counsel (if any)

Counsel for Requestor:

Name

Mailing Address

City/State/Zip County

Telephone

Fax Email

Counsel for Other Party Involved (If known):

Name

Mailing Address

City/State/Zip County

Telephone

Fax Email

Section 5: Type of Request

Please check only one: ☐ Workmanship and Materials Inspection ☐ Structural Inspection ☐ Joint Inspection

Workmanship and Materials
Alleged defect(s) due to the questionable quality and performance of the materials or method used to construct the home, including a defect in the plumbing, electrical, heating and air conditioning delivery systems.

Structural
Alleged defect(s) to the home which include, but are not limited to, the foundation or other load-bearing portions of the home.

Section 6: Information Regarding Alleged Defect(s)

Please list each alleged defect(s) in the home construction and for each, the date when the defect was first noticed. Include only those alleged defects of which both parties have knowledge through prior notice. DO NOT attach the notice letter in lieu of completing this section. Please note if Workmanship and Materials (W/M) or Structural (S).

	Alleged Defect	Date	Room	(W/M) or (S)
1.				
2.				
3.				
4.				
5.				
6.				
7.				
8.				
9.				
10.				
11.				
12.				
13.				
14.				
15.				

Section 7: 30-Day Written Notice

1. Date 30-day written notice of defects was provided to builder: _____(MM/DD/YYYY). Attach copy of written notice.
2. Provide a general description of the builder's response to written notice of alleged construction defect(s) and if any portion of that response was provided in writing, please attach a copy of the written response. (Attach extra pages, if necessary.)

_____

_____

Section 8: Warranty

Identify warranties applicable to the alleged defects.

Type of warranty:

- ☐ 3rd Party Warranty
  Company: _____
- ☐ Builder Warranty
- ☐ No Warranty
- ☐ Other _____
  Explain: _____

Attach any and all written warranties regarding the construction of the home/remodel. Include a copy of the entire warranty, not only those pages pertaining to the alleged defects.

Section 9: Additional Information and Attestation

1. Please provide an itemized list of all (a) out-of-pocket expenses and (b) out-of-pocket engineering or consulting fees incurred by the Requestor in connection with the alleged construction defect(s): (Attach extra pages, if necessary.)

(a) Out-of-pocket expenses:

_____

_____

_____

(b) Out-of-pocket engineering or consulting fees:

_____

_____

_____

2. Please list the names and addresses of all professionals or other persons, known to the Requestor, who have inspected the alleged construction defect(s) on behalf of the Requestor (see EXCLUSIONS listed in the instructions). (Attach extra pages, if necessary.)

_____

_____

_____

3. Please attach or enclose copies of any documents or other tangible things that depict the nature and cause of thealleged construction defect(s) and that depict the nature and extent of repairs necessary to remedy the construction defect(s), including, expert reports, photographs, and videotapes, if these documents and tangible things are either within the Requestor's physical possession or if the Requestor has the right to obtain the document or tangible thing from a third party, such as an agent or a representative of the Requestor (See EXCLUSIONS listed in the instructions).

To the best of my knowledge, I certify that all information provided in this SIRP Form is true and correct.

Signature _____ **Date** _____

NOTE: It is required that the Requestor send a copy of this SIRP Request (except page 4) and all ENCLOSURES AND ATTACHMENTS to the Other Party Involved in the dispute by certified mail, return receipt requested. Please initial here to acknowledge you have complied with this requirement. _____

Texas Residential Construction Commission
Quality Construction for Texans

STATE-SPONSORED INSPECTION AND DISPUTE RESOLUTION PROCESS (SIRP)
Fee Page

Note: Do **NOT** send a copy of this page to the other involved party.

Section 10: Requestor Name

Name _____ Telephone _____

Section 11: Remitter Information

Name _____ Company – Type of Company (if applicable) _____

Mailing Address _____ City _____ State _____ Zip _____

Telephone _____

Social Security Number or Federal ID Number (optional)* _____

*This information will be required in an event of a reimbursement. If you chose to wait to provide this information, your reimbursement may be delayed.

Section 12: Payment

☐ Workmanship and Materials Inspection Fee = $350.00
☐ Structural Inspection Fee = $450.00
☐ Joint Inspection Fee (Structural w/ Unrelated Workmanship and Materials) = $650.00

☐ **Check** *(Payable to TRCC)* ☐ **Money Order** *(Payable to TRCC)*

☐ **Credit Card** *(Provide information below)* ☐ **Financial Reduction/Waiver Request** *(Attach Fee Waiver form)*

Credit Card Information *(Select Card)* ☐ MasterCard ☐ Visa ☐ American Express ☐ Discover

Card Number ☐☐☐☐ ☐☐☐☐ ☐☐☐☐ ☐☐☐☐

Expiration Date ☐☐☐☐ Month Year

Print name as it appears on card _____ Signature _____

Internal Use Only

Billing Address _____ City _____ Zip Code _____

Section 13: Submit Form and Payment via Mail, Fax or Hand Delivery

Mail to: P.O. Box 13144, Austin, TX 78711
Fax to: (512) 463-9507
Delivery: 311 E. 14th Street, Suite 200, Austin, Texas 78701

For Information call: (877) 651-TRCC or (512) 305-TRCC

www.trcc.state.tx.us

The Texas Residential Construction Commission obtains information from this form and certain third-party sources. With few exceptions, you may review and correct the information we collect. To be informed about the information we collect or to make an open records request, contact our Legal Department at 512-463-1040 or open.records@trcc.state.tx.us.

Section 6 (Continued): Information Regarding Alleged Defect(s)

Please list each alleged defect(s) in the home construction and for each, the date when the defect was first noticed. Include only those alleged defects of which both parties have knowledge through prior notice. DO NOT attach the notice letter in lieu of completing this section. Please note if Workmanship and Materials (W/M) or Structural (S).

Alleged Defect	Date	Room	(W/M) or (S)

PHILADELPHIA
ATLANTA
CHARLOTTE
CHERRY HILL
CHICAGO
DALLAS
LAS VEGAS
LONDON
LOS ANGELES

COZEN
O'CONNOR
ATTORNEYS

NEWARK
NEW YORK
SAN DIEGO
SAN FRANCISCO
SEATTLE
TRENTON
WASHINGTON, DC
WEST CONSHOHOCKEN
WICHITA
WILMINGTON

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2300 BANKONE CENTER 1717 MAIN STREET DALLAS, TX 75201-7335
214.462.3000 800.448.1207 214.462.3299 FAX www.cozen.com

November 15, 2004

ATTACHMENTS 1-6 FOR SIRP REQUEST FORM

Dear Sir or Madam:

Homeowner Insurance Company ("Carrier") and Harry and Helen Homeowner have retained this law firm in connection with the structural damage and subsequent mold contamination that occurred at the above-referenced residence. As a result of payments made and/or to be made pursuant to an insurance policy between Carrier Insurance Company and Harry and Helen Homeowner, Carrier is entitled to assert its rights of subrogation against the builder of the home, Bad Custom Homes, Inc. ("Custom Homes"). The following is the narrative response for Section 6, Items 1-6.

Section 6: Item 1. Please list and give a reasonably detailed description of the alleged defect(s) in the home construction and for each, the date when the defect was first noticed. Include only those alleged defects for which both parties have knowledge. If the Requestor is the homeowner, please attach documentation showing that the builder was provided 30 days written notice of the alleged defect(s) listed. (Attach extra pages, if necessary.)

The home was built in 2002. The Homeowners are the original owners of the property. In April 2004, the Homeowners had reached an agreement to sell the home to a third party. At that time, Smith Inspection Group, Inc. conducted a pre-sale property inspection. Mr. Smith noted several structural problems with the home. These included a "heavy wood beam in to soil and standing water in crawlspace under wine cellar." There was also water standing and heavy sewage contamination in two crawl spaces in the lower east section of the home and drainage problems with the south west corner of the main crawlspace. A complete copy of Mr. Smith's report is attached as Exhibit A.

Over the next several weeks, the Homeowners attempted to resolve these problems with the potential buyer. Michael Engineer, P.E., of Michael's Engineers, Inc. prepared a report which is attached as Exhibit B. A second engineer, R. Kelly, with Conglomerate Engineering Co., also issued a report. It is attached as Exhibit C. The construction defects with the home are:

ITEM NO.	DESCRIPTION	DATE FIRST NOTICED
1.	Elevation variances in the home of +/- .05 inches	4/29/2004
2.	The steel beam in the NE corner of the dinning room was not adequately supported	4/29/2004
3.	the piers and girders were not supported properly in the NE corner of the SW bedroom	4/29/2004
4.	the south side dining room girder was not properly supported	4/29/2004
5.	the girder in the wine cellar was installed too close to the soil and partially disintegrated	4/29/2004
6.	non-pressure treated material in contact with concrete under the wine cellar and cabana	4/29/2004
7.	lumber in contact with soil under wine cellar	4/29/2004
8.	improperly supported beam ends in dining room and SW bedroom	4/29/2004
9.	missing lintels across windows at master bath	4/29/2004
10.	inadequate ventilation under wine cellar	4/29/2004
11.	water has accumulated in the crawlspace under the wine cellar and cabana and caused high humidity and fungal growth	4/17/2004
12.	plywood beams bolted to concrete foundation are wet and saturated with water	07/14/2004
13.	beam in wine cellar extended down to, and sometimes into, the crawlspace soil. It was crushed along the bottom of the beam atop the concrete support.	07/14/2004
14.	the beam in the wine cellar is too close to the ground	07/14/2004

15.	the crawlspace is not adequately ventilated.	07/14/2004

Custom Homes has inspected the home more than once and a copy of the notice letter is attached as Exhibit D.

Section 6: Item 2. Provide a general description of the builder's response to written notice of alleged construction defect(s) and if any portion of that response was provided in writing, please attach a copy of the written response.

Custom Homes has inspected the home at least once but the problems have not been resolved. Since the 30 day period for inspection has passed, we are currently awaiting whether Custom Homes will make an offer of settlement pursuant to RCLA/RCCA. *See* Exhibit E, F and G.

Section 6: Item 3. Please provide an itemized list of all (a) out of pocket expenses and (b) out-of-pocket engineering or consulting fees incurred by the Requestor in connection with the alleged construction defect(s): (see EXCLUSIONS listed on page 3 or the instructions). (Attach extra pages, if necessary.)

OUT OF POCKET EXPENSES	AMOUNT
Michael's Engineers	$900.00
Pool Table disassembly	$185.00
Conglomerate Engineering	$568.00
Remediation Co.	$74,988.16
Forensic Lab Co.	$3,943.55
TOTAL	$80,584.71

Section 6: Item 4. Please list the names and addresses of all professionals or other persons, known to the Requestor, who have inspected the alleged construction defect(s) on behalf of the Requestor (See EXCLUSIONS listed on page 3 of the instructions)(attach extra pages, if necessary.)

1. Michael Engineer, P.E.
   Michael's Engineers, Inc.
   1778 N. Plano Road, #200

Richardson, Texas 75081

2. R. Kelly, P.E.
Conglomerate Engineering Co.
2455 McGyver Lane
Tyler, Texas 75006

3. Ivan Smith
Smith Inspection Group, Inc.
2100 N. Houston Blvd.
Katy, Texas 77150

4. John Doe, MA, RS
Forensic Lab Co.
330 Elm Street
Houston, Texas 77017

5. Jeff Johnson
Homeowner Insurance Company
2001 Main Street
Dallas, Texas 75201

Section 6: Item 5. Please attach or enclose copies of any documents or other tangible things that depict the nature and cause of the alleged construction defect(s), including expert reports, photographs, and videotapes, if these documents and tangible things are either within the Requestor's physical possession or if the Requestor has the right to obtain the document or tangible thing from a third party, such as an agent or representative of the Requestor (See EXCLUSIONS listed on page 3 of the instructions).

See Exhibits A, B, C, and H (video portion entitled "Wine Cellar").

Section 6: Item 6. Please attach any written warranties regarding the construction.

None known at this time.

Texas Residential Construction Commission
Quality Construction for Texans

Home Registration Form

Is this home registration related to a State-Sponsored Inspection and Dispute Resolution Process (SIRP)? ☐ Yes ☐ No

Section 1: Builder/Remodeler Information

Builder/Remodeler Company Name | TRCC Registration Number

Mailing Address (not a P.O. Box) | City | State | Zip Code

Telephone Number | E-mail | Primary Agent or Contact Name

Section 2: Registrant Information–*Complete ONLY if registrant is an individual or company other than the Builder/Remodeler,(e.g. Homeowner, Title Company)*

Mailing Address | City | State | Zip Code

Name of Registrant | E-mail | Telephone Number

Section 3: Home Registration *(for multiple home registrations attach Additional Home Registration Form)*

Street Address of Home | City | State | Zip Code | County

Section 4: Type of Registration

Select only one option: A, B, C or D.

☐ **A. New Home Construction With Title Transfer (on Builder's Lot)**

Date of Title Transfer

☐☐ Month ☐☐ Day ☐☐☐☐ Year

☐ **B. New Home Construction Without Title Transfer (on Homeowner's lot)**

Required: *Provide the homeowner's current mailing address if different from Section 3.*

Mailing Address | City | State | Zip

☐ **C. Material Improvement** (home construction that increases or decreases the square footage of the living space of the home; e.g. room additions).

☐ **D. Interior Renovation in excess of $20,000.**

Required: *If B, C or D is selected, choose the earliest occurring event and provide a date below:*

☐ **1. Date of contract; or**

☐ **2. Date work began**

☐☐ Month ☐☐ Day ☐☐☐☐ Year

Section 5: Calculate Payment and Certification

Number of Homes x $30 + (Late fee- additional $30 per home, if applicable) = TOTAL FEE ☐

Signature of Builder/Remodeler or Registrant | Printed Name | Date

Homes registered online receive a discount rate of $25 per home. For more information, visit www.trcc.state.tx.us or call toll free (877) 651-TRCC

Section 6: Payment

☐ **Check** *(Payable to TRCC)* ☐ **Money Order** *(Payable to TRCC)* ☐ **Credit Card** *(Provide information below)* ☐ **501(c)3**

Credit Card Information *(Select Card)*

☐ MasterCard ☐ Visa ☐ American Express ☐ Discover

Card Number ☐☐☐☐ ☐☐☐☐ ☐☐☐☐ ☐☐☐☐

Expiration Date ☐☐☐☐ Month Year

Internal Use Only

Print name as it appears on card | Signature

Billing Address | City | Zip Code

Section 7: Submit Form with Payment via Mail, Fax or Hand Delivery

Mail to: P.O. Box 13144, Austin, TX 78711 **Fax to:** (512) 463-9507 **Hand Delivery:** 311 E. 14th Street, Suite 200, Austin, TX 78701

The Texas Residential Construction Commission obtains information from this form and certain third-party sources. With few exceptions, you may review and correct the information we collect. To be informed about the information we collect or to make an open records request, contact our Legal Department at 512-463-1040 or open.records@trcc.state.tx.us.

Revised 1-21-05

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VIA FACSIMILE (512) 463-9507

Texas Residential Construction Commission
Attn: Complaint Department
311 E. 14th Street, Suite 200
Austin, Texas 78701

Re: **State-Sponsored Inspection and Dispute Resolution Process (SIRP)**

Home Builder: Bad Custom Homes, Inc.

Dear Sir or Madam:

In December 2004, this firm filed the appropriate documentation to request initiation of the State-Sponsored Inspection and Dispute Resolution Process (SIRP) for both Harry and Helen Homeowners (the "Homeowners") and their homeowner's insurance carrier, Homeowner Insurance against Bad Custom Homes, Inc. We paid the $450.00 filing fees and submitted all the appropriate documentation along with a copy to the home builder.

We received a letter from Ms. Durso, General Counsel for the TRCC, advising that Homeowner Insurance did not have to participate in the SIRP. Ms. Durso also asked us to advise whether the Homeowners wished to proceed with the SIRP as it related to their claims.

Please be advised that the Homeowners wish to immediately initiate SIRP proceedings and respectfully request that you arrange for an inspection of their home.

Thank you for your attention to this matter. If you have any questions, please do not hesitate to contact me directly.

Sincerely,

COZEN O'CONNOR

By: JOE ATTORNEY

PREAMBLE TO ORDER OF ADOPTION FOR
10 TEXAS ADMINISTRATIVE CODE CHAPTER 304
WARRANTIES AND BUILDING AND PERFORMANCE STANDARDS

The Texas Residential Construction Commission ("commission") adopts new Chapter 304, relating to Warranties and Building and Performance Standards. Subchapter A, §§304.1-304.3, subchapter B, §§304.10-304.33, subchapter C, §§304.50-52 and subchapter D, §304.100, are adopted with changes to the proposed text as published in the October 22, 2004 issue of the *Texas Register*. The new chapter outlines the statutorily mandated minimum warranties and performance standards for residential construction throughout the State of Texas.

The sections are adopted to implement House Bill 730 (Act effective Sept. 1, 2003, 78th Leg., R.S., ch. 458, §1.01). The new sections are adopted under Property Code §408.001, which provides general authority for the commission to adopt rules necessary to implement Title 16, Property Code; Property Code Chapter 426, which requires the commission to implement warranties and performance standards for use in the State-sponsored Inspection and Dispute Resolution Process (SIRP); and Property Code §430.001, which provides specific authority to adopt rules establishing limited statutory warranty and building and performance standards for residential construction.

The commission has determined that these sections will become effective on June 1, 2005. These sections will apply to all residential construction that commences on or after June 1, 2005, if the construction is for a new home, material improvement to an existing home or an interior renovation to an existing home that costs in excess of $20,000. For the purpose of determining applicability, the date of commencement is the earlier of the date that the parties enter into an agreement for a transaction governed by the Act or the date that work commences on or after June 1, 2005. The commission has revised the proposed sections to state the effective date in §304.1(b).

Subchapter A, General Provisions, §§304.1- 304.3, provides for definitions, the applicability of the International Residential Code and National Electrical Code to residential construction, the implementation of warranty and performance standards and general conditions that identify builder and homeowner responsibilities. The subchapter describes general builder responsibilities, general homeowner responsibilities and general exclusions from or conditions affecting the application of the performance standards contained in the chapter. The subchapter also describes the minimum warranty periods adopted by the commission and the warranty of habitability.

Subchapter B, Performance Standards for Components of a Home Subject to a Minimum Warranty of One-Year for Workmanship and Materials, §§304.10-304.33, provides performance standards for those components of a home or home improvement that are subject to the minimum one-year warranty period provided for in subchapter A of this chapter. This subchapter provides standards for components of a home including foundations, framing, doors, windows, electrical fixtures, plumbing accessories, cooling and heating systems, interior trim, fencing and pest control. The standards include statements of builder and homeowner responsibilities and exclusions where applicable.

Subchapter C, Performance Standards for Plumbing, Electrical, Heating and Air-conditioning Delivery Systems Subject to a Minimum Warranty Period of Two Years, §§304.50-304.52, provides for performance standards for plumbing, electrical, heating and air-conditioning delivery systems that are subject to the minimum two-year warranty period provided for in subchapter A of this chapter. This subchapter provides for specific standards of performance for elements such as wiring, breakers, electrical fixtures, plumbing accessories, pipes, wastewater treatment systems, heating and cooling system components and ductwork. The standards include statements of builder and homeowner responsibilities and exclusions where applicable.

Subchapter D, Performance Standards for Major Structural Components of a Home Subject to a Minimum Warranty Period of Ten Years, §304.100, provides performance standards

for foundations and other structural components of a home that are subject to the minimum ten-year warranty provided for in subchapter A of this chapter.

The commission enlisted the assistance of the Texas A & M University College of Architecture, Construction Science Department ("TAMU") in the development of the warranties and building and performance standards. The TAMU faculty and students attempted to develop a list of each component of a home in which a defect is likely to occur. Each component then was assigned a performance standard. To develop the warranties and to assign a performance standard to each component TAMU: 1) reviewed the standards of other states, warranty companies and the industry; 2) considered the minimum standards in the International Residential Code, the National Electrical Code and the U.S. Housing and Urban Development standards; and 3) considered the cost impact and regional climactic differences of each performance standard. TAMU's draft was then provided to the commission for the final development of an initial "working draft". This "working draft" was then disseminated to the public and posted on the agency's website. Written comment on the working draft was invited and received.

To ensure statewide participation in the development of the new warranties and performance standards, the commission held informal "town hall" styled meetings in Houston, McAllen, Austin, San Antonio, Laredo, Lubbock Longview, Dallas and El Paso from August 3 to August 31, 2004. The stakeholder audiences included engineers, inspectors, homeowners and builders. The commission also held a public meeting in its offices on September 9, 2004 in which a representative of TAMU engaged in dialogue with attendees on their comments and suggestions regarding the working draft. From the written comments, verbal comments and suggestions on the proposed draft and the dialog with the various audiences regarding their concerns, the commission revised its draft proposal. Many of the issues raised and comments suggested were incorporated into a final version that was accepted by the commission as a proposal for publication at the commission's October 5, 2004 Open Meeting.

The proposed new sections were published in the October 22, 2004 issue of the *Texas Register* and a period of thirty days was provided for acceptance of public comment on the proposed rules. A correction was published in the October 29, 2004 issue of the *Texas Register* at (29 TexReg 10172) regarding §304.12(g). Notice provided that interested persons could submit written comments (12 copies) on the proposed sections to Susan K. Durso, General Counsel, Texas Residential Construction Commission, P.O. Box 13144, Austin, Texas, 78711. The commission also accepted comments submitted electronically to comments@trcc.state.tx.us, if "Chapter 304 comments" was placed in the subject line. Notice provided that comments sent to another electronic address or that do not have "Chapter 304 comments" in the subject line may not be considered. Comments not timely received were not considered.

Finally, the commission held a public hearing to accept oral comments on the rules pursuant to Tex. Gov't Code §2001.029 at the commission offices on November 9, 2004. Those who appeared and provided oral comment were Victor Drozd, representing the Bryan-College Station Homebuilders Association (BCSHA); Roger Williams and Shaw Wulfson, who are also with the Bryan-College Station Homebuilders Association (included in references to BCSHA); Robert F. Pierry, Jr., P.E., owner of Roger Bullivant of Texas and representative of the American Society of Civil Engineers (Pierry); Larry Foster (Foster); Scott Norman, Vice President and General Counsel of the Texas Association of Builders (TAB); Mark Eberwine (Eberwine); Steve Pawlowski, Law Offices of Anne Stark, P.C., attorneys representing homeowners and builders (Stark); Glenn Motheral, owner of Austin Design Build of Fort Worth and representing the Greater Fort Worth Builders Association (GFWBA); Janet Ahmad, representing Homeowners for Better Builders (HOBB); Randy Streetman, representing Streetman Homes (Streetman); and Llewel Walters, representing Lennar Homes (Lennar).

The commission received written comments from Brant Roeming, Bonded Builders Home Warranty of Texas (Bonded Builders); John R. Cobarruvias, Homeowners Against Deficient Dwellings of Texas (HADD); Mark Eberwine (Eberwine); W.T. Little (Little); Jay Dyer of TAB; Kimberley Jacobs of BCSHA (BCHSA); James T. Houston, P.E., PhD (Houston); Mark Daigle,

Tilson Home Corporation (Tilson); Robert Peirry, Jr. (Pierry); Fred Parker, Fred Parker Company, Inc. (Parker); Janet Ahmad, HomeOwners for Better Building (HOBB); Tom Bothell (Bothell); Sam Beck, Miller Brothers Floors (Miller); John "Chip" Henderson (Henderson); Greg Parish, Parish Electric Co. of Fort Worth, Inc. (Parish); Larry J. Foster, Foster Inspections & Construction Consulting, Inc. (Foster); Doug Larkins, ACES A/C Supply (Larkins); David Grissom, Foundation Performance Association (Grissom); Dennis Vint (Vint); Marius J. Mes, Ph. D., P.E., Foundation Performance Organization (FBO); Carol Baker, Capitol City Insurance Agency (Baker); Jim Poage, texRES - Highland Lakes (Poage); Kimberly Kapavik, Greater San Antonio Builders Association (GSABA); Anne P. Stark and Steven J. Pawlowski, Law Office of Anne P. Stark, P.C. (Stark); Pam Borchert, Victoria Builders Association (VBA); Gregory A. Harwell, Gardere & Wynne (Harwell); and Albert Hernandez, No-Burn of Bexar County (No-Burn).

If the commission received both oral and written comments from an individual or representatives of an entity, the commission will refer to the comment without distinguishing whether the comment was received orally or in writing.

All comments regarding these sections that were properly addressed and timely received, including any not specifically referenced herein, were fully considered by the commission. In addition to revisions resulting from comments received, the commission has made other minor modifications to the proposed sections for the purpose of clarifying its intent and improving style and readability.

The commission received written comments from Bonded Builders and HADD suggesting training for third-party inspectors who are appointed by the commission pursuant to 10 Texas Administrative Code §313.11 (10 TAC §313.11) on the standards set forth in these sections. The commission agrees with Bonded Builders and HADD on this issue and notes that training is required by commission rule 10 TAC §303.207 and by Prop. Code §427.001(d); however, these comments have not resulted in any changes to the proposed text in these sections. Poague added that the term "third-party inspector" should be defined and that such an inspector should be at least International Code Council (ICC) Code combination certified. Third-party Inspectors appointed by the commission meet the requirements adopted by the commission in 10 TAC ch. 303, including the requirement that the third-party inspectors be ICC Code combination certified when required by statute.

Section 304.1(a) sets forth the scope of chapter 304. Eberwine and Foster suggested that the commission revise §304.1(a) by adding the language "and shall comply with the applicable sections of the I.R.C. and N.E.C." to the very last sentence of the subsection. Foster explained that this addition would make clear that all provisions of the Code apply because many readers do not understand that the Code incorporates many standards by reference. The commission agrees that reference to the applicable codes would clarify the commission's intent and, thus, it has added language to the section accordingly. HADD commented that assigned third-party inspectors should be allowed to make a determination on a defect that is not covered by the adopted performance standards based upon the inspector's training. However, the proposed language for §304.1(a) is grounded in the statutory language of Prop. Code §401.002 and provides an objective standard for the third-party inspectors. Therefore, the commission declines to make a change based on HADD's comment regarding this section.

Section 304.1(b) which included the definitions as proposed has become §304.1(c) in the adopted rule. Section 304.1(c) includes definitions to be used in chapter 304. Eberwine commented on the definitions, including that the definition of "adverse effect" should not be limited to habitable areas of the home but also should include the exterior, garage, attic, utility rooms, closets, etc., of a home. Property Code §430.002(b) provides that for a construction defect to be actionable as a breach of the warranty of habitability it must have an adverse effect on the habitable areas of the home. The commission uses the term "adverse effect" in this chapter only as it relates to the warranty of habitability and the commission's use of the term tracks the statutory language.

On the definition of "builder responsibility," Eberwine suggested clarifications to the definition to make clear whether the parties' agreement to an alternative remedy could include

repairs that were lower than the performance standards adopted by the commission or the International Residential Code (IRC), National Electrical Code (NEC), or manufacturer's specifications. Once the commission-adopted performance standards are effective, a builder must build to the minimum performance standard; therefore, a builder who repairs a construction defect must repair that defect such that it at least meets the commission-adopted performance standard for that component. However, the parties to a construction dispute may agree to an alternative remedy for resolving their dispute rather than the builder making a repair to bring the construction defect into compliance with the performance standards. The commission believes that the language as written is clear and accurately expresses the commission's intent.

Eberwine suggested that the definition of "Code" as it relates to the IRC and the NEC is unclear as written because he is unsure of when the context might require reference to the NEC as opposed to the IRC. The commission finds that the definition is clear as written and declines to make changes to the definition. If the context refers to electrical matters and the reference is to the Code, it references the NEC.

The commission received comments from Eberwine, Little and TAB on whether the definition of "condition" is necessary given changes that were made during the drafting process. The commission agrees that the definition is no longer necessary and in fact may cause confusion because of the number of times in which the word is used in its ordinary meaning throughout the proposed sections. Therefore, the commission has deleted the definition.

Eberwine and representatives of BCSHA and the VBA have questioned the definitions of "Electrical Standard" and "International Residential Code." Eberwine suggested that the commission should refer to a single version of the IRC and NEC in order to promote uniformity throughout the state and BCSHA and VBA suggested that the commission refer to the state in its entirety rather than making separate statements for municipalities and unincorporated areas. Foster also commented on references to the county seat in unincorporated areas of the state because the municipality that houses the county seat may not have adopted the IRC or NEC. The commission has proposed adoption of the language mandated by Property Code §430.001, which requires that the commission standards refer to the IRC and NEC exactly as stated in the proposed definitions. Accordingly, the commission declines to make changes to these definitions.

The commission received comments from several who commented on the performance standards, including BCSHA and VBA, regarding use of the word "excessive." The commission finds that its definition of "excessive" is adequate for interpreting the proposed performance standards in which the term is used.

HADD expressed concern that the definition of "extreme weather condition" would not allow for the variety of geographical conditions in Texas. However, the IRC, which is contained in the definition, provides different standards for different geographical regions. Accordingly, no change is necessary.

BCSHA and VBA seek clarification on the definition of "habitable area," which refers to the commission's adopted definition of "living space" in 10 TAC §301.1(14). "Living space" is defined as the enclosed area in a home that is suitable for year-round residential use. The commission finds this definition self-explanatory and declines to make revisions to this section as a result of BCSHA's and VBA's comments. Stark also commented that garage and attic spaces should be included in the definition of "habitable area" to ensure that latent defects in mechanical systems in the garage and attic spaces are not excluded from the warranty of habitability. However, the commission does not agree with Stark's analysis that the proposed language would exclude from coverage under the warranty of habitability a defect which occurs in a non-habitable area of the home but which causes damage to a habitable area of the home. Property Code §430.002(b) provides that for a construction defect to be actionable as a breach of the warranty of habitability it must have an adverse effect on the habitable areas of the home. Accordingly, the commission has not made a change to the proposed text as a result of Stark's comment on this section.

Stark opined that the definition of IRC in §304.1(c)(9) lessens the minimum standard that the commission is required to adopt by inclusion of the words "substantial compliance." Further,

Stark notes that the IRC states that it "establishes minimum regulations..." Stark believes that the commission "should not lessen the 'minimum standards of performance' by not requiring full compliance with the 'minimum regulations' of the IRC." The commission notes that substantial performance under a construction contract is the legal equivalent to full compliance. See *Uhlir v. Golden Triangle Development Corp.*, 763 S.W. 2d 512, 515 (Tex. App. – Ft. Worth 1988) writ denied. Accordingly, the commission declines to make the requested change. However, the commission notes that Ms. Stark made a converse argument regarding the definition of "homeowner responsibility"; therefore, the commission has added the idea of "substantial compliance" to that definition to clarify its intent.

Harwell, Foster, Eberwine and Houston commented on the definition of "major structural components." Harwell suggested that the language of the definition should be exclusive rather than inclusive as proposed. In contrast, Eberwine suggested adding expansive language "including but not limited to" and specifically listing "headers" among those items identified as major structural components. Houston recommended the addition of masonry arches to the listed items because masonry arches are of the same ilk as lintels. Foster suggested that "ceiling framing" be included as a part of roof framing systems. The commission agrees that headers, masonry arches and ceiling framing should be added to the list of structural components, but also agrees that the list of structural components should be exclusive. The text was modified to reflect the commission's evaluation of the comments.

GSABA suggested that the commission add "engineered manufactured structural components" to the definition of "manufactured product." However, the commission finds that such an addition would change the meaning of the section such that it would no longer reflect the commission's intent. The commission's reference to manufactured products applies to consumer items that are incorporated into a home with little or no change from when delivered by the manufacturer. Inclusion of the term suggested by GSABA may permit the definition to include components that are modified to fit the design of each residential construction situation.

The commission received comments from Tilson, Houston, Stark, Eberwine, HADD, Houston, Pierry and Little on the definition of "original construction elevations." Little commented that garages and outbuildings that are not part of a monolithic foundation should be excluded. The commission finds that the proposed definition, by expressly stating that actual elevations include garages and porches 'if those structures are part of a monolithic foundation,' implicitly excludes garages and porches that are not part of a monolithic foundation; thus, no change is necessary.

Several of the commenters expressed concern that the actual elevations be recorded. Of these suggestions, the commission finds that the most practical method for maintaining the elevations would be to require the builder to keep them in the builder's file for the ten-year period of the warranty. The original homeowner might not retain the elevations or provide them to a subsequent purchaser. The commission does not have the resources to maintain elevation documentation on each home registered with the commission. Finally, it behooves the builder to maintain the original elevation records should future claims regarding the foundation be made. If the builder fails to maintain the elevations or chooses not to take the elevations, the foundation is presumed to be level at plus or minus three-quarters of an inch off level for the entire length of the foundation. Accordingly, it is in the builder's best interest to maintain the elevations. However, since there is no requirement that builders maintain the elevations, the commission has deleted that portion of the definition.

Another common concern was determining the point in construction when the elevations should be taken. The commission believes that the builder should have the latitude to determine when the elevations should be taken; thus, the elevations should be taken at anytime before substantial completion. Other comments addressed the frequency with which the elevations are taken. Also, Tilson suggested that elevations be taken at the perimeter corners of the home. However, the commission finds that taking elevations at the perimeter corners alone would not provide enough information. Pierry suggested that elevations should be taken at 'fairly regular intervals on the surface of the entire foundation at a rate of at least one elevation per 100 square

feet.' Harwell offered that to establish original construction elevations the 'elevations shall be taken at an approximate rate of at least one elevation per 100 square feet, subject to obstructions.' The commission determined that Harwell's language provides the best combination of guidance and flexibility, so the definition has been changed in accordance therewith. In addition, the commission has revised the section to require that the elevations depict a reference point and a description of the floor.

Tilson suggested increasing the presumption for construction elevations to be level to one inch; however, the commission finds that plus or minus three-quarters of an inch over the length of the foundation is a reasonable presumption for levelness. A builder has the option to rely on the stated presumption or to take elevations if there is a concern that the presumption does not provide enough latitude.

On the definition of 'performance standard' Eberwine commented that the word "should" should be replaced with "must." The commission agrees and has changed the text accordingly. The commission has also added the word "component" to the definition for clarity because the term is used frequently in the performance standards to refer to an element of a home.

On the definition of 'substantial completion' Eberwine noted that in paragraph (A) using the term "earlier" could create a situation in which the warranty period has commenced, but the home has not been sold. The commission agrees that such was not the intended result and has changed the definition accordingly. Comments were also received regarding paragraph (C) from Foster, Poage and Eberwine. The suggestions included removing the language regarding the construction lender and adding the requirement that the inspection be performed by an ICC Inspector who has a combination certification. Upon reflection, the commission has determined that requiring an inspection in an unincorporated area would add an unnecessary cost to the homeowner. By deleting paragraph (C) the homeowner or the builder may choose to incur the cost for an inspection prior to closing or occupancy, but neither is required to do so.

Harwell suggested that the commission add a definition for 'structural failure.' The commission agrees that the definition would be helpful, but finds that it would be a substantial change to the proposed rules, which requires an opportunity for public comment. Therefore, the commission will adopt a definition in a proposed amendment to the commission's rule on general definitions.

Section 304.1(d) provides a method for third-party inspectors to resolve conflicts among standards. Stark, Foster and Eberwine all suggested that the commission delete the language regarding agreements between the parties because it may create greater ambiguity or provide an opportunity for lowering a standard below the standards adopted by the commission. The point is well-taken and the language has been deleted. Harwell commented that the inclusion of the Texas Section of the American Society of Civil Engineers Recommended Practice for the Design of Residential Foundations (2002) (ASCE) would cause a dramatic increase in the cost of home construction. Furthermore, these ASCE standards are not definitive, but provide construction options and are preempted by building codes and municipal inspection standards. The commission finds that Harwell's points are valid and has deleted reference to the ASCE standards in this section. However, ASCE standards are used in the proposed performance standards when the commission determined that they provided the most objective standard for evaluating an alleged construction defect. GSABA suggested the addition of the "Guidelines for the Evaluation and Repair of Residential Foundations (2002); however, the commission declines to include those standards for the same reasons it is deleting the ASCE standards in this conflicts section.

Section 304.2 provides for general provisions that relate to all new residential construction to which the commission-adopted performance standards will apply. Section 304.2(a) states builder's responsibilities, §304.2(b) states exceptions to the builder responsibilities and §304.2(c) states homeowner responsibilities. Section 304.2(a)(1) provides that the builder is responsible for all work performed under the builder's direction for the period of the applicable warranty and incorporates statutory timetables for making a request to initiate the state-sponsored inspection and dispute resolution process that is in Property Code §426.005(b). Stark expressed concern

that subsection (a)(1) could be misconstrued to suggest that the warranty of habitability was only for two years. Stark suggested amendment to §304.3 to include language that the warranty of habitability is ten years. The commission has added language to §304.3 to clarify that the warranty of habitability is a ten year warranty.

Poage suggested that §304.2(a)(1) should address third-party inspections that take place prior to completion of construction and commencement of the warranty period. However, the commission-adopted performance standards are used to evaluate construction performance after the warranty period commences.

Section 304.2(a)(2) addresses a builder's responsibility regarding recommended repairs if the builder makes repairs as a result of a third-party inspector's report, or if that report is appealed, the recommendations of the appellate panel. Foster suggested that the section reference that the repair be consistent with the Code, as did Poage and Eberwine. Eberwine also suggested that the section make clear that any agreement made by the parties with regard to repair cannot fall below the strictest standard. The commission agrees that the builder who undertakes a repair recommended by a third-party inspector pursuant to §313.14 of this title shall make the repair consistent with the Code, the performance standard or §304.2(a) of this chapter. If the inspector does not make a recommendation for repair, the builder who undertakes to make a repair shall make it in accordance with the Code or the usual and customary building practices, or as agreed by the parties, so long as any agreed upon repair does not fall below the Code or the performance standard, whichever is strictest.

With regard to §304.2(a)(3), repair condition, Eberwine suggested that the commission replace the word "cosmetic" with the word "proper". The commission declines to accept the suggestion; however, it has revised the section to better state its intent.

Section 304.2(a)(4) refers to correcting finishes after a repair. Both Harwell and Streetman suggested that the language "acceptable to the homeowner" may create unnecessary controversy and that the section could be improved. The commission accepts Harwell's suggestion to delete "acceptable to the homeowner" and add "substantially similar in appearance."

HADD expressed concern on the §304.2(a)(5) provision regarding "manufactured products" that latent defects would be excluded. However, the proposed text provides that a homeowner must notify the builder of a defect within two years of discovery or not later than thirty days following the applicable warranty period provided in §304.3(a). This section incorporates that statutory timetable for making a request to initiate the state-sponsored inspection and dispute resolution process.

Parker and Eberwine addressed §304.2(a)(6) regarding design standards. Parker interpreted the section to require homeowners to sign off on all house plans, including speculative homes. Eberwine expressed concern that the section on design standards may allow designs to fall below commission-adopted performance standards. Based on the comments the commission has decided to label this section "specialty features." The commission does not intend that homeowner's sign off on all house plans, including speculative homes. The commission's intent is to allow builders to accommodate special design features into construction that may not meet the performance standards adopted by the commission; however, even if special design features, such as rough-textured dry-wall, do not meet the performance standard for surface depressions, the wall still must be built in accordance with the Code.

Stark opined that §304.2(b), which describes exceptions and exclusions to the builder's responsibilities for repair, loss or damage to a component of a home, should track the language of the Residential Construction Liability Act (RCLA) regarding percentage of responsibility. The builder's responsibility is to repair or replace components that have construction defects that are the result of actions taken by the builder or at the builder's direction. The commission finds that the exclusions and exceptions listed in §304.2(b), as revised for adoption, appropriately limit the builder's responsibilities for repair. However, to ensure that if a portion of a component is defective, lost or damaged as a result of construction activities, the commission has revised the

proposed language to include portions of a component. Foster and Eberwine suggested that builders should supply maintenance and care manuals to homeowners. The commission understands that new homeowners may not be aware of home maintenance and care requirements; therefore, the proposed sections offer maintenance information when such is necessary and adds clarity to the performance standard. Further, the commission has plans to publish maintenance guidelines to assist new homebuyers in caring for their investment.

Foster suggested that the exclusion in §304.2(b)(1)(D) for alterations to the grade of soil should be limited to alterations that are not in compliance with the IRC. Eberwine made a comment similar to Foster's. The commission agrees with Foster's suggestion and adds that the exclusion should only apply to alterations that are not in compliance with the IRC or applicable government regulations. Poague suggested that the proposed language would cause builders to fail to properly grade the soil so as not to be responsible for grading at all. However, the commission does not agree because builders are required to comply with the IRC and applicable governmental regulations when undertaking residential construction projects.

Stark commented on the exclusion for changes to the underground water table that may affect the home in §304.2(b)(1)(I). She recommended that foundations be deleted from this exclusion because a builder may argue that wet weather conditions on highly expansive clay soils is a change in the water table. Foster raised the issue of the builder's responsibility for actions taken at the time of construction that may affect the water table. Houston, Eberwine, HADD and HOBB made similar comments. The commission agrees that a change in the water table that is the result of remedial actions taken or not taken by the builder at the time of construction is a part of the builder's responsibilities.

HADD and Poage both submitted comments on the exclusion for erosion or accretion of soils that are not the result of a construction defect in §304.2(b)(1)(J). The commission declines to make a change to this exclusion. It is clear from the language of the proposed text that erosion or accretion of soils that are the result of a construction defect are the responsibility of the builder.

Regarding §304.2(b)(1)(P), Harwell stated that the exclusion for damage caused to existing trees, shrubs or other plants that result from the work necessary to construct the home is "somewhat ambiguous." Stark and Houston opined that the builder should be responsible for taking existing vegetation into account when building a home and planning the foundation. Eberwine questioned the need for such an exclusion. HADD wanted to add language "unless the builder planted them." The commission has determined that the exclusionary language is not clear and has deleted it.

Regarding §304.2(b)(1)(R), Eberwine stated that remodelers should be able to correct existing conditions that do not meet performance standards during construction so there should be no exclusion from performance standards for those that cannot be achieved as a result of pre-existing conditions. The commission does not agree because conditions may exist that prevent a remodeler from achieving certain performance standards when undertaking construction on an existing home.

Foster, Poage, HADD and Eberwine all expressed concern that if the builder is not responsible for a condition that does not cause actual physical damage as stated in §304.2(b)(2), some problematic conditions would be allow to stand uncorrected until a disastrous situation occurred. However, the proposed language provides that the exclusion does not include conditions that are the result of a construction defect. Accordingly, if the condition is a direct result of a construction defect, the builder is responsible for correcting the condition. HOBB stated that the exclusion was in violation of HUD standards, but the commission finds that those standards are not subject to exclusion.

Section 304.2(c) discusses a homeowner's responsibilities including home maintenance under §304.2(c)(1). Foster, Stark, Houston and Eberwine all provided comments on the requirements that homeowners perform periodic soil maintenance on their homes and lots under §304.2(c)(3) and all suggested that the builder has some level of responsibility for providing homeowners with guidance on maintenance. The commission agrees that soil maintenance

should be covered in a maintenance guide and not the performance standards. Therefore, the commission deleted the provision.

Similar comments were provided by Foster, BCSHBA, Eberwine and HADD regarding landscape watering under §304.2(c)(4). However, the commission finds that the proposed language offers straightforward guidance regarding the need to avoid excessive moisture accumulation near the foundation and an explanation of how landscape watering may create an imbalance in moisture that could affect the foundation performance.

Harwell suggested revised language for the landscape planting provision in §304.2(c)(5) and the commission agrees with the suggested language. Therefore, the commission has modified the section in accordance with Harwell's revisions. Foster raised the issue of providing the homeowner with information on landscape planting, but the commission has addressed that issue and agreed that homeowners may need guidance. Therefore, in addition to the changes made, guidance will be provided in another document. To the extent that Foster has made a similar comment regarding other homeowner responsibilities, the commission believes the issue has been addressed. HADD raised a comment about grading as it relates to landscaping, but soil grading is addressed elsewhere in the standards.

HADD, Eberwine and Foster raised questions about how a homeowner might prevent excessive moisture accumulation as required in §304.2(c)(6). As a result of the comments, the commission has revised the section to better explain its intent that homeowners have a responsibility to recognize that there are conditions that may cause damage if left unabated and to utilize ventilation equipment as needed to alleviate those conditions.

Eberwine maintained that if a homeowner is responsible under §304.2(c)(7) for chemicals found in tap water, then the builder should provide information on the chemical content of the water. The language to which Eberwine refers was offered as explanatory and is not necessary to understand the meaning of the maintenance requirement. The commission deleted the second sentence to alleviate the problem.

Eberwine also commented on §304.2(c)(8) that the builder should also be required to take reasonable action to prevent further damage to the home under the section entitled "self-help." The commission included this section to address the issue of mitigation of damages. If a homeowner discovers that the washing machine is overflowing from the drain, the homeowner should turn off the water to prevent further damage and sop up the spillage to avoid further damage to flooring and walls. The builder cannot take action without notice of a problem. The commission finds that the section is clear and does not need revision as suggested by Eberwine.

Section 304.3, Limited Warranties, has been revised as a result of a comment made by Stark that the warranty period for the warranty of habitability was unclear. The commission has added language to clarify that the warranty of habitability is a ten-year warranty.

The commission received similar comments from VBA, BCSHBA, and Parker on §304.3(b) that the Magnuson Moss Act provides all the coverage needed to a consumer regarding the warranties on manufactured consumer products. Tilson requested the deletion of the last sentence that requires the builder to take action to correct a warrantable manufactured product if the manufacturer timely fails to take action. The commission finds that a builder is responsible for providing quality products to homebuyers. If the manufacturer fails to comply with its warranty provisions within a reasonable period of time, the builder should bring the condition into compliance with the performance standard and seek redress from the manufacturer. The builder is not required to warrant the product in any greater degree than the terms of the manufacturer's warranty under this subsection.

Harwell suggested that the language "foundations and major structural components" under §304.3(e) is redundant and that only 'major structural components' is necessary. The point is well-taken and the commission has revised the subsection accordingly.

Regarding §§304.3(f)(2) and 304.3(f)(3), the commission received comments from Harwell, TAB, Little, Poage, Stark and HADD. The language of the section as proposed incorporated the

terms stated in Property Code §430.002. However, Harwell provided a suggested revision that better states the statutory requirements. The other comments received are either addressed by the changes suggested by Harwell, are covered elsewhere in the proposed sections (e.g. the definition of habitability or the length of the warranty period) or contradict the statutory provisions regarding the warranty of habitability.

Regarding §304.3(f)(4), Eberwine correctly noted that a request to participate in the state-sponsored inspection and dispute resolution process for a breach of the warranty of habitability must be made within two years of the date of discovery of the alleged construction defect but not later than "thirty days" after the effective date of the warranty period. The commission has made that correction.

Property Code §430.007 prohibits the inclusion of a provision in a contract between a homeowner and builder that would waive the limited statutory warranties and building and performance standards adopted by the commission pursuant to Property Code ch. 430 and specifically provides that the parties may contract for more stringent requirements. Although the commission received comments from Tilson and Eberwine seeking to change §304.3(i), which restates Prop. Code §430.007, the commission declines to make the suggested changes because the proposed text is substantially similar to the statutory language supporting it.

With regard to Subchapter B, the Performance Standards for Component of a Home Subject to a Minimum Warranty of One Year for Workmanship and Materials §§304.10-304.33, the commission received several comments throughout regarding the meaning of "construction activities," including comments from HADD regarding most sections in which the term is used. The commission will adopt a definition for "construction activities" in a rule amendment proposed contemporaneously with the approval of these sections to clarify that it means the actions taken by a builder or remodeler, or an employee, agent, contractor or subcontractor of a builder or remodeler, or anyone acting at the direction of the builder or remodeler during the building process of building or remodeling the home.

Section 304.10(a): Foster and Eberwine commented on the performance standard for grading in a crawl space. Both expressed concern that grading should not permit water to stand in a crawl space. The commission finds that use of the term "surface runoff" as opposed to "water" and use of the term "accumulate" as opposed to "stand" will more accurately reflect its intent. The commission agrees that grading should be such that surface runoff does not accumulate in a crawl space and that exterior drainage around a perimeter crawl space wall shall not allow water to stand within ten feet of the foundation, except in a sump that drains into other areas. The commission has determined that the provision related to exterior grading is consistent with standards used in other states. Eberwine also commented that the homeowner should be allowed to modify existing grading so long as the modifications are properly done. The commission agrees and has modified the text to reflect its agreement.

With regard to §304.10(a)(2)(B) Eberwine also commented that homeowners should be allowed to make proper modifications to grade. Again, the commission agrees and has modified the text.

The commission received comments from Foster, VBA, Poage, Bonded Builders, Tilson, Eberwine, Houston, TAB, Parker and BCSHBA on §304.10(b)(1). This proposed section provides that concrete slab floors in living spaces, excluding finished concrete floors and intentionally sloped floors, shall not have excessive pits, depressions or unevenness equal to or exceeding 3/8 of an inch in any 32 inch measurement and shall not have separations or cracks that equal or exceed 1/16 of an inch in width or 1/16 of an inch in vertical displacement. Foster, Poage and Houston complained that the standard for unevenness, at 3/8 of an inch in any 32 inches, is excessive. In addition, Houston and Poage raised a question as to whether this standard could be construed as applying to the levelness of slabs foundations. The commission finds that the 3/8 of an inch measurement in 32 inches refers expressly to issues of depressions, pits and unevenness of the surface, not levelness, which is addressed in §304.100, regarding tilt in slab foundations. The commission does not find that the measurement is too lax. VBA, Bonded Builders, Tilson, TAB, Parker and BCSHBA all noted that the standard for separations and cracks

of less than 1/16 of an inch in width and 1/16 of an inch in vertical displacement is too tight and is inconsistent with related performance standards regarding flooring. VBA added that repair of a 1/16 of an inch wide crack may create more damage than allowing it to stand. Based on the fact that the proposed performance standard for a finished concrete floor prohibits a crack of less than 1/8 of an inch in width and such is the current industry standard , the commission has modified the proposed text in this section to 1/8 of an inch as it relates to the width of a crack or separation, but not as to vertical displacement. The commission finds that if a vertical displacement of 1/16 of an inch is discovered in an interior concrete slab in the first year, it should be considered a construction defect.

Within the same performance standard, §304.10(b)(3), on concrete slabs, the proposed text provides that a separation in an expansion joint or a control joint shall not equal or exceed one-quarter of an inch vertically or one inch horizontally from an adjoining section because of settlement, heaving or separation. Houston commented that the one inch horizontal separation at a control joint is excessive and added that the one-inch standard is inconsistent with other performance standards regarding horizontal displacement. Eberwine noted that the language of "settlement, heaving or separation" opens the door for conflicts regarding the reason for the displacement. First, the commission finds that control joints are rare in foundations in residential construction; therefore, it has deleted the reference to control joints in this subsection and in subsequent standards that reference control joints. Second, the commission agrees with Eberwine that the language regarding the cause for movement and deletes the reference to the cause of the separation. However, the commission finds that proposed measurements for horizontal and vertical movement at a separation joint between concrete slabs is appropriate given that the purpose of the separation joint is to allow room for movement.

Section 304.10(c) states the performance standards for exterior concrete. The commission received numerous comments on the performance standards for cracks appearing in exterior concrete flatwork as provided in §304.10(c)(2). VBA, Tilson, Parker, Streetman and BCSHA complained that the performance standards were too stringent for exterior concrete work that is exposed to the environment and that requiring performance to the stated standard would increase costs of construction. Foster, Stark and Eberwine conversely argued that the standard was too lax and that builders should be able to construct flatwork that did not have cracks 1/4 of an inch or greater within the first year. The commission finds that heretofore exterior concrete flatwork has not been warranted typically in the residential construction industry. Furthermore, exterior concrete flatwork is subject to elements, such as varied soil moisture or external pressure, that may affect its performance and requiring all exterior concrete flatwork to be constructed with reinforcement materials would increase the cost of construction. For these reasons, the commission believes that the standard as proposed provides reasonable performance for a one year period. Thus, the commission declines to make any changes to the performance standard as stated in §§304.10(c)(1)-304.10(c)(2)(B).

In §304.10(c)(2)(B) the commission has included a statement of the homeowner's responsibility of reasonable maintenance of uniform soil moisture content around exterior flatwork and also for preventing heavy equipment to be parked on the flatwork. Foster and Eberwine have taken issue with these exclusions stating that a builder should be building for given soil and weather conditions and Eberwine declares that use of the term "heavy equipment" is unclear. Little asked that the commission delete this section entirely because of the potential for heavy equipment to be placed on exterior flatwork. The commission believes that homeowners have some obligation to be aware of conditions around their homes and to maintain them by use of reasonable care. Further, the commission finds that the term "heavy equipment" is a term of art commonly used and understood in the construction industry. In addition to the comments received, commission has determined that the language in §304.10(c)(2)(C) is superfluous and has deleted this paragraph.

Houston, Eberwine and Streetman made similar comments regarding §304.10(c)(5), which addresses the performance standard for horizontal and vertical movement in expansion joints in exterior concrete flatwork as they made regarding §304.10(c)(2), which addresses horizontal and vertical cracks in exterior concrete. Streetman stated that expansion joints are incorporated into

flatwork to permit movement between the slabs and that at least a one-half of an inch horizontal displacement rather than one-quarter of an inch should be allowable. Foster recommended that the commission reduce the proposed performance standards to one-quarter of an inch vertical separation and one-half of an inch horizontal separation. Foster based his recommendation on ACI standards and "old FHA and VA Minimum Property Standards." Foster also noted that ergonomic studies regarding walking and climbing stairs and the IRC standards for stair variations. The proposed performance standards in this section do not include exterior stairs, which are addressed elsewhere. The commission again bases its performance standards for exterior flatwork on the fact that exterior flatwork has previously was not included in warranties for residential construction and that exterior flatwork is subject to external elements that affect its performance to a greater degree than interior concrete. Further, with regard to expansion joints, the purpose of the joint is to permit movement in recognition of the external elements that can cause exterior concrete surfaces to move. Therefore, the commission declines to accept any of the suggested changes to the performance standards in this section.

Section 304.10(c)(6) provides a standard of performance for vertical and horizontal separations at control joints in exterior concrete flatwork. Eberwine, again, suggested deleting the portion of the standard that refers to cause for separation. For the reasons stated above, the commission agrees and changes the language accordingly.

Foster and Eberwine provided comments on the performance standard for separation of exterior concrete stairs from the home in §304.10(c)(9). Eberwine reiterated his suggestion that including a statement regarding cause for separation from the home would cause unnecessary debate and the commission agrees. Foster stated that the proposed one-inch tolerance was too great. The commission has determined that one inch is appropriate but that to improve clarity the paragraph needs modification to provide that the measurement includes any joint material.

Section 304.10(c)(11) addresses depressions, pits, unevenness and separations or cracks, not at expansion joints, found in concrete floor slabs that are not included in living spaces, but in detached garages, carports and porte-cocheres. Stark's comment demonstrated that the standards as proposed were not clear with regard to garages that are not a part of a monolithic slab. Accordingly, the commission added the term "detached" before "garage" to provide clarity. Although Tilson commented that the tolerance of less than 3/16 of an inch in the width of cracks and separations is too small, the commission is satisfied that the performance standard proposed is not too small for a one year warranty period if the problem is one of workmanship and materials.

HADD noted that the proposed performance standards for exterior concrete do not include the construction of a driveway that is too steep. The commission considers this to be a design issue and not a performance issue.

Section 304.11 sets forth performance standards for framing. Subsection (a) provides that a wall shall not bow or have depressions that equal or exceed `/4 of an inch out of line with any 32-inch horizontal measurement as measured from the center of the bow or depression or 1/2 of an inch in any eight-foot vertical measurement. VBA, Parker and BCSHBA all asserted that the "National Guideline" is that a wall shall not have bows or have depressions that are "greater" than 1/2 of an inch in any eight foot measurement. The "National Guideline" to which they refer is the National Association of Home Builders (NAHB) guidelines. In arriving at the proposed standards and allowances for performance the commission has tried to balance the competing interests of homebuilders for keeping costs low and the interests of homebuyers to purchase a well-built home that functions as intended and that is aesthetically pleasing. The commission has determined that a better standard for framing is that the measurement should be less than 1/2 of an inch; therefore, it declines to make the suggested change.

Section 304.11(a)(2) states that walls must be level, plumb and square to all adjoining openings or other walls within 1/4 of an inch in any 32-inch measurement. VBA, Parker and BCSHBA again refer to the NAHB guidelines and suggest that the appropriate standard should be "equal to or greater than 3/8 of an inch in any 32-inch measurement..." Foster avers that the IRC standard for wood frame construction is a maximum out-of-plumb at 3/4 of an inch in an

eight-foot measurement and that changing the standard to 3/8 as suggested would exceed that maximum standard. Houston maintains that the proposed variance for plumb at 1/4 of an inch in 32 inches is excessive and should be considered a poor construction practice. The commission finds that the current standard is actually 3/4 of an inch in a 32-inch measurement; therefore, the commission agrees with the builder representatives that the 1/4 of an inch standard is too tight. Accordingly, the commission has revised the standard to "within 3/8 of an inch in any 32 inch measurement..."

In §304.11(a)(3) provides that a crack in a beam or post shall not equal or exceed 1/2 of an inch in width at any point along the length of the crack. Foster suggested adding the language "or it is determined that the beam or post is no longer capable of carrying its design loads." The commission agrees that it is paramount in framing that a beam or post be able to carry its design loads and that the failure to do so would be a construction defect. Foster's suggestion addresses the concern raised by Eberwine that a beam or post must function as intended. Also, several builder representatives (VBA, ADB and Parker) pointed out that the appropriate terminology is beam or post and not "post and beam," which is a framing detail.

HADD commented that the language in §304.11(a)(4)(B) appeared to create an excuse for warped beams and posts because it notes that posts and beams are subject to drying and cracks may result. The commission has determined that such explanatory information is superfluous to the performance standard and therefore, that language has been removed.

Section 304.11(a)(5) provides that exterior sheathing shall not delaminate or swell. Tilson called into question use of the term "sheathing," which is a material applied to the exterior of the home for bracing or insulation and suggested that the correct term should be "siding." Eberwine suggested that the proposed remedy should be worded to provide that if the sheathing failed to meet the performance standard the builder shall "replace the sections [affected.]" With regard to both comments, the commission finds that the section accurately expresses the performance standard as the commission intended. Accordingly, the commission made no revisions as a result of these comments.

Section 304.11(b) states the performance standards for ceilings. Subsection (b)(1) provides that ceilings shall not bow or have depressions equal to or exceeding 1/2 of an inch out of line within a 32-inch measurement as measured from the center of the bow or depression running parallel with a ceiling joist. Foster and Eberwine both suggested that the standards should not allow a bow or depression to equal or exceed 1/4 of an inch in a 32-inch measurement. Foster also felt that the standard is inadequately defined for an inspector to know how to take such a measurement; however, he offered no alternative language.

The commission has determined that the ceiling standard for framing is the same as the ceiling standard for ceilings constructed of drywall and that the standards of both as proposed is appropriate and acknowledges the difference between construction of a ceiling and construction of a wall. With regard to the method of measurement, the commission has made the standard more clear by stating that the measurement shall be from the center of the bow or depression running parallel with a ceiling joist or within 1/2 of an inch deviation from the plane of the ceiling within any eight-foot measurement.

Section 304.11(c) states the performance standards for sub-floors. Eberwine took issue with including a statement of cause for floors that emit excessive noise during normal residential use in subsection 304.11(c)(1) and 304.11(c)(1)(A). The commission agrees and has revised the standard. For subsection 304.11(c)(2) regarding damage to the subfloor as a result of delamination or swelling, Eberwine suggested the addition of "or can be felt through the floor covering when walked upon." However, the proposed text provides that delamination or swelling of the subfloor should not result in "observable physical damage" to the floor covering. The commission believes that use of the term "observable" encompasses observation as a result of use of any of the senses. Foster recommended that the standard for ridges and humps in subfloors, which is proposed to be less than 3/8 of an inch in any 32 inch measurement, should be 1/4 of an inch in any ten foot measurement. The proposed standard for subflooring is consistent with the proposed standard for floor coverings. The commission has relied on the input

of TAMU in developing standards that offer the homebuyer sound construction without unnecessary or prohibitive increases in cost. This proposed standard achieves the commission's goal and thus will not be changed as a result of Foster's comment.

Section 304.11(d) includes performance standards for stairs. Poage and Eberwine both provided comments on the language used to describe the standard for excessive noise resulting from stairs subjected to normal residential use. Eberwine again commented on the issue of cause "directly attributable to loose stair treads or framing" and the commission agrees with his comment. Poage commented that requiring the builder to bring stairs that make excessive noise to within the stated standard creates a loophole, because the builder should bring the stairs to within Code. The overall requirement for performance presumes that construction is built at least to the applicable Code; therefore, there is no need to alter the standard as proposed.

Section 304.12 states the performance standards for drywall. Subsection (a) states the standard for bows and depressions; subsection (b) states the standard for ceilings made of drywall; subsection (c) states the standard for cracks in drywall; subsection (d) states the standard for crowning in drywall; subsection (e) states the standard for ridges and beads appearing at drywall joints; subsection (f) states the standard for drywall surface imperfections, such as blisters and trowel marks; subsection (g) states the standard for levelness of a drywall surface; and subsection (h) states the standard for the visibility of nails or screws in a drywall surface. Although the commission received comments from VBA, GSAB, Parker, BCSHBA, Tilson and ADB suggesting that the standard in subsection (a) that a bow or depression in a drywall surface shall not equal or exceed one-quarter of an inch out of line within any 32-inch horizontal measurement or one-half of an inch in any eight-foot vertical measurement, is too stringent as compared to the NHAB guidelines. The standards stated for walls and ceilings constructed with drywall in subsections (a) and (b) are consistent with the standards stated for framing in §304.11. For the same reason the commission declined to make changes to the proposed standards for wall and ceiling framing based on the NHAB guidelines, the commission declines to make those same suggested changes for walls and ceilings constructed of drywall.

Foster and Eberwine made suggestions for revising the proposed text in subsections (a) and (b) that they thought would clarify the text. However, the commission does not find that the suggestions of either offer any clarification to the commission's intent, so the commission declines to accept the suggestions.

On subsection (b) regarding ceilings, Foster also expressed concern that the proposed standards would permit deflection of the ceiling up to two and a quarter inches in a twelve-foot room. The commission believes that if each measurement is taken in accordance with the language in the proposed text, drywall ceilings that are performing as proposed will not have bows and depressions that allow the ceiling to deflect from one end of the room to the other to a degree of two and a quarter inches.

Comments from builder representatives, including VBA, Tilson, Parker, Lennar and BCSHBA all protest that the performance standard that does not permit cracks equal to or greater than 1/32 of an inch during the one year warranty period for workmanship and materials is rigorous and that a better standard would be one-sixteenth of an inch. Conversely, Eberwine stated that any crack appearing in drywall during the first year is too great. Stark concurred with the commission that the proposed standard is reasonable. The commission having evaluated these comments concludes that the standard as written is reasonable when balancing the competing interests of consumers and the construction industry.

Section 304.12(d) provides that crowning at a drywall joint, which is when the drywall joint is higher than the plain of drywall board on either side of the joint, should not equal or exceed one-quarter of an inch within a twelve-inch measurement centered over the drywall joint. Foster declared that the performance standard should be one-sixteenth of an inch in the same measurement because anything as large as one-quarter of an inch is a "bulge." He further stated that the gypsum industry standards are less than one-quarter of an inch. Section 304.1(c) provides a method for resolving conflicts among standards. If the manufacturer's standard is more stringent than the performance standard adopted by the commission, the more stringent

standard applies. Eberwine expressed concern that this standard for crowning at drywall joints would permit a bumpy surface of one-quarter of an inch bumps at every drywall joint when measured perpendicular to the surface. However, the commission finds that with the other standards for drywall surfaces, the drywall surface standards should achieve aesthetically acceptable uniformity for walls and ceilings covered in drywall. GSABA suggested that the standard could be made better by adding an exception for corner beads, which are designed to be embedded in a coat of drywall compound because different manufacturers' products vary at the level that they protrude. GSABA and BCSHBA suggested that crowning along corner beads should not equal or exceed three-eighths of an inch within any twelve-inch measurement. The commission concurs with the GSABA and BCSHBA comments and has revised the proposed standard to incorporate the suggested language.

As a result of Eberwine's query as to how one would reconcile subsection (e) regarding ridges along drywall joints and subsection (d) regarding crowning, the commission has reconsidered the need for subsection (e) as proposed and has deleted it.

In several of the performance standards proposed, the commission received various comments from builder industry representatives regarding use of the term "natural light" rather than "normal light." Those providing comments noted that because of the variety of lighting conditions that may exist from home to home, it is better to consider each alleged defect in the lighting conditions normal for that particular home, rather than "natural light," which suggests sunlight. The commission agrees with these comments and has replaced "natural light" with "normal light" throughout the standards. Eberwine suggested that in addition to changing the visibility standard for surface imperfections regarding lighting that the surface should be viewed for imperfections from a distance of two feet as opposed to six feet. The commission finds that the standard is intended to promote an appearance of overall uniformity of a surface and that six feet is a more reasonable distance from which to view a surface and gauge the overall appearance. Accordingly, the commission has not reduced the distance from which a drywall surface should be viewed for uniformity.

Foster, Little and TAB commented that §304.12(g) regarding the levelness, plumbness and squareness of a drywall surface, should read "shall *not* be out of level" and Tilson made a similar comment as a result of an accidentally omitted "not" in the sentence when published. This was an inadvertent error and a correction notice was published by the commission in the October 29, 2004 issue of the *Texas Register* as noted above. GSABA and BCSHBA averred that the standard should be deleted because it was already addressed in other standards; however, the commission finds that this is a necessary standard to address the performance of a drywall surface. Eberwine raised an important issue with regard to remodeling existing homes in which the pre-existing conditions may make compliance with this performance standard difficult. He suggested that in order to qualify for the exclusion for pre-existing conditions that do not meet the standard, the builder or remodeler must notify the homeowner prior to the commencement of work that the standard cannot or will be difficult to achieve. Eberwine's point is well-taken; however, some conditions may not be apparent prior to the commencement of work. Therefore, the commission has modified the section to incorporated Eberwine's notice of notice, but has revised it to reflect that construction may have commenced. Eberwine suggested that the commission expand the performance standard regarding visibility of nails or screws in drywall surfaces by adding that nail or screws should not create depressions or outlines that are visible in drywall surfaces. However, the commission finds that the issues raised by this comment are addressed by other performance standards regarding drywall performance.

Eberwine offered additional language for the performance standard for insulation under §304.13(a) to make clear that insulation must be installed in accordance with building plans and the Code. Further, he provided language to address that the absence of insulation in unheated and non-air-conditioned areas of the home may affect the performance in heated and cooled areas. Eberwine also suggested that the term "restricts" is better than "blocks" when discussing the impairment of a soffit vent by insulation. The commission adopted the substance of Eberwine's suggestions in this section but not the precise language. Tilson suggested that the commission refine the language regarding gaps between batts of insulations or adjacent framing

by including a measurement of three-eighths of an inch as the maximum allowable gap. The commission has determined that 1/4 of an inch is a better standard and has made clear that there is an allowable gap between batts but no allowable gap between a batt and a framing member. By adding the measurement between batts, the standard now addresses the concern stated by Lennar that the standard would effectively eliminate the use of batt-type insulation.

Section 304.14 addresses various performance standards for exterior siding and trim. More than one comment was received regarding the different performance standards that may be affected by the use of natural wood siding as opposed to a manufactured siding product that has uniformity. The commission considers natural wood siding to be a specialty feature that should be addressed per contract specifications, including the fact that natural wood varies and has imperfections that are natural characteristics of wood. The performance standards for exterior siding presume the use of a manufactured siding product that has greater uniformity from piece to piece. VBA and Parker maintain that the requirement that siding be equally spaced and aligned such that it shall not be more than one-quarter of an inch off parallel with the adjacent course of siding from corner to corner is too rigid a measurement. Eberwine's comment indicated that he did not understand the meaning of the terminology "corner to corner" as used in the proposed standard. However, the commission does not find that the standard is too difficult to achieve or that proposed standard is unclear because by referring to the adjacent course, the standard makes clear that the measurement is relative to the abutting course of siding at a corner.

In §304.14(a)(3), the proposed performance standard does not permit nails to protrude from the finished surface of siding, unless such is within the manufacturer's specifications for installation. The commission has revised the section to make more clear that if nail heads are visible it must be in accordance with manufacturer's specifications by adding language to §304.14(a)(3) and deleting §304.14(a)(3)(B). Eberwine commented that the cure for siding that exhibits nail stains should be to replace the siding nails. However, the commission believes that the suggested remedy would cause more damage to the siding than alleviating the rust condition.

Section 304.14(a)(6) states that siding shall not delaminate or cup in an amount equal to or exceeding one-quarter of an inch in a six foot run. Eberwine suggested that the more appropriate standard would be that siding shall not delaminate or cup at all. ADB suggested that the measurement should be one- quarter of an inch in a 32 inch run. The commission finds that the proposed standard achieves the best balance between adequate performance and cost to construct to the standard. However, the commission has separated the two standards for delamination and cupping to improve clarity.

Similarly, the commission has proposed that siding shall not have cracks or splits in an amount equal to or exceeding one-eighth of an inch in width. ADB suggested that the appropriate standard would be one-quarter of an inch, which the commission finds is too great, and HADD suggested that siding should not have splits or cracks of any size, which the commission finds too rigid. Accordingly, the commission has not revised this section as a result of the comments received.

Subsection (b) of §304.14 addressed the performance of exterior trim. Eberwine professes that trim joints shall not have any separation and should not be caulked. Construction costs outweigh the benefit of permitting a small separation that is caulked and further joints may experience expansion and contraction depending upon weather conditions. Stark had issues with requiring caulk between trim and regularly shaped masonry units such as brick. However, the joints between trim and masonry surfaces are addressed in the performance standards related to masonry.

The commission received comments from stakeholders on several of the subsections related to the performance of exterior trim that suggested that the measurements proposed for cupping, warping, cracks or splits should be larger or smaller depending upon the alignment of the stakeholder. However, upon review, the commission finds that the measurements it has proposed for performance standards are neither too difficult to achieve nor too lax a standard. In reaching this conclusion the commission has considered the potential additional cost for construction, the reasonable expectations of the home buying public for the performance of a

well-built home within the first year. Like the performance standards for the visibility of nails from the finished surface of exterior siding, nail heads shall not protrude from the finished surface of exterior trim, although the presence of the nail may be detectable on some products. Likewise, if trim shows a nail stain, the builder must alleviate the stain. Accordingly, the commission has not revised the performance standards proposed for exterior trim as a result of the comments received from Eberwine, ADB, Streetman and BCSHBA.

Section 304.15 and its subsections address the performance standards for masonry, including brick, block and stone. Subsection (a) provides that a masonry wall shall not bow in an amount equal to or exceeding one inch in any eight-foot length when measured from the base to the top of the wall. Houston and Eberwine both asserted that the standard would allow a wall in excess of eight feet high to bow excessively. As a result of these comments, the commission has revised the stated standard to provide that a masonry wall may not bow in an amount equal to or exceeding one inch when measured from the base to the top of the wall. Subsection (c) provides that masonry mortar shall not have cracks that equal or exceed one-eighth of an inch in width. VBA, Parker, Lennar and BCHSHBA opined that a more realistic measurement for masonry mortar cracks would be 3/16 of an inch. HADD, Eberwine and Houston all asserted that one-eighth of an inch was too great. HADD's comments indicate that it is not differentiating between cracks in mortar and cracks in the brick unit. However, the performance standard addresses masonry mortar and mortar shrinks as it cures. As a result of shrinkage, mortar may exhibit superficial cracking that does not affect the integrity of the structure. Therefore, the commission declines to either increase or decrease the proposed performance standard.

Section 304.15(d) states that masonry units and mortar shall not deteriorate. Although Houston, Eberwine and HADD expressed a variety of concerns ranging from how to determine the quality of the brick unit installed to addressing the performance of the moisture barrier that is behind masonry, the commission finds that this performance standard is clear and expresses the appropriate expectation for masonry unit and mortar performance.

In like fashion to §304.15(d), §304.15(e) states that masonry shall not have dirt, stain or debris on the surface as a result of construction activities. Again, the commission believes that the performance standard as stated is reasonable and sets a clear expectation. Although, Baker suggested that the performance standard should state the method for removing dirt, stain or debris, the commission prefers that the builder determine an acceptable method to bring the masonry to within the expected performance standard and that the remedy may depend upon the cause of the failure to perform.

Section 304.15(f) as proposed set forth the performance standards for gaps between masonry joints. All of the comments received on this section indicated confusion and consternation with the commission's intent. The confusion expressed is understandable because the commission intended to refer to gaps between masonry units and adjoining surfaces, which is addressed in the next subsection. Therefore, the commission has deleted this subsection.

Gaps between masonry units and adjacent materials shall not equal or exceed one-eighth of an inch and all such gaps shall be caulked. The comments of VBA, Tilson, Parker, Lennar, Eberwine and BCSHBA all addressed the differing expansion rates between adjacent surfaces and that various textures may have gaps greater than one-eighth of an inch. All except Eberwine offered that the appropriate measure for such a gap should be less than one-quarter of an inch in average width. Eberwine included that the gaps need to be caulked as a moisture barrier. The commission agrees and has revised the standard to provide that gaps between masonry surfaces and adjacent materials must be caulked and less than one-quarter of an inch.

Section 304.15(h), now §304.15(g), provides that mortar shall not obstruct functional openings, such as weep holes, vents and plumbing cleanouts. Foster suggested that the commission delete weep holes from this standard and VBA, Parker, BCSHBA, Lennar and GSABA contend that masons cannot avoid getting mortar in weep holes. However, the purpose of a weep hole is to create a functional opening for the release of moisture; accordingly, the commission has not revised this section.

Section 304.16 provides performance standards for stucco. Subsection (a) allows that a stucco surface shall not be excessively bowed, wavy or uneven. As a result of a comment received from Eberwine the commission has revised the section to read "stucco surfaces" rather than "a stucco surface". Subsection (c) addresses cracks that may appear in a stucco finish. Cracks that do not equal or exceed one-eighth of an inch in width at any point along the crack do not violate the performance standard in subsection (c). Both Eberwine and HADD protested the allowance of any cracks in a stucco surface within the one-year warranty. However, cracking does occur as a result of normal shrinkage and curing; thus, the commission finds that the performance standard as proposed is reasonable. Nonetheless, the commission has deleted the explanatory language in paragraph (2) of subsection (c), because, as with other explanatory notes offered throughout the proposed text of the performance standards, the standard speaks for itself and a defect that fails to meet the performance standard is covered by the applicable warranty.

Eberwine suggested that the commission add the word "visibly" and delete the word "excessively" in the stucco performance standard that prohibits excessive deterioration of stucco. However, the commission finds that the performance standard as proposed adequately expresses the commission's intent.

Subsection (h) of the performance standards on stucco provides that a gap between stucco joints shall not equal or exceed 1/16 of an inch in width. VBA, GSABA, Parker, Streetman, ADB and BCSHBA all protested the performance standard set at less than 1/16 of an inch, preferring instead that the commission adopt the NAHB standard of 1/8 of an inch. The commission declines to adopt the NAHB standard, which the commission as determined is insufficient for first year warranty expectations. Bonded Builders pointed out that the term "gap" is imprecise when referring to an intentional joint placed to allow for expansion and contraction of the stucco surface. The commission agrees and has revised the section to provide that "separations" at joints must meet the stated standard. The commission made this same correction in subsection (i), which refers to separations between stucco and adjacent materials.

Subsection (j) states that stucco shall not be allowed to obstruct a functional opening, such as a weep hole, a vent or a plumbing cleanout, much like the performance standard for masonry mortar. Eberwine suggested that the commission should add "or other weep hole areas," but the commission does not see that such an addition would be particularly helpful. Eberwine also suggested that the commission add a section providing that "all stucco wall sections shall be constructed so that there is a functional 'weep area' at the base of the stucco wall section." The commission is adopting performance standards and not stating construction requirements as are already covered by the IRC or manufacturer installation specifications.

Subsection (k) addresses the minimum screed clearance for stucco. The commission had proposed that the screed have a minimum clearance above soil or landscape surfaces of eight inches and that it have clearance above other surfaces of at least two inches. Eberwine suggested that the clearance over soil should be four inches, as did Henderson. Foster suggested that requiring eight inches of clearance would increase the required elevation of foundations. The commission reviewed the 2000 IRC and the 2003 IRC for stucco and reviewed the 2000 and 2003 IRC for Exterior Installation Finish Systems (EIFS). Although the 2000 IRC stated no clearance standard for stucco, the 2003 requires a minimum clearance of four inches above soil and a minimum of two inches above paved surfaces. For EIFS, the 2000 and 20003 versions require a six inch clearance for paved and unpaved surfaces. Therefore, the commission is revising subsection (k) to require that stucco screed clear soil or landscape materials by four inches and paved surfaces by two inches. Further, the commission is adding a section for EIFS that screed clearance be at least six inches above paved or unpaved surfaces.

Section 304.17 sets out the performance standards for roofs. HADD commented that the section does not include a requirement for attic ventilation. However, attic ventilation is required by the IRC and the performance standards do cover blocked ventilation. Accordingly, the commission declines to make the requested change. This section also contains a specific exclusion for failure of roof performance as a result of extreme weather. HADD protests the

inclusion of this exclusion on the basis that it believes the term "extreme weather" is inadequately defined. Poage made a similar comment about use of the term "extreme weather" in this section. The commission has determined that the IRC incorporates applicable construction requirements for weather conditions that can be expected to be the norm in different geographic regions. Builders are required to construct to the IRC specifications applicable to the region in which the home is built. Therefore, again, the commission believes that use of the term "extreme weather" as it has been defined by the commission conveys adequate information for its intended purpose.

In §304.17(h), which refers to damaged roof tiles, the commission included the term "chipped." Parker, VBA and ADB all noted that if a tile is cracked or broken, it is also "chipped" to the degree that structural integrity might be compromised, but that a roof tile may have an insignificant "chip" that neither impairs aesthetics nor functionality. The commission agrees and has revised this subsection accordingly.

Section 304.17(i) provides that objects designed to penetrate a roof placed within a roof valley centerline require "cricketing" or other Code-approved water diversion methods. Eberwine suggested that the commission specify that such objects placed within a twelve-inch distance of a roof valley centerline require Code-approved water diversion methods, but also suggested that the term "cricketing" be removed. The commission finds that the standard is clear as proposed.

Eberwine also commented that roofs should not allow water penetration, regardless of reason, as implied in subsection 304.17(j). The commission concurs and has revised the section as a result of the comment.

Section 304.18 includes performance standards for doors and windows. HADD noted several possible construction defects for doors and windows that it felt were not addressed by §304.18. However, after reviewing the listed items, the commission believes all the possible conditions are covered elsewhere, either in the IRC or in the proposed performance standards.

Throughout the performance standards, and in this section on windows and doors, the term "excessive" is used to describe conditions outside the norm. The term is defined and the commission finds that, as defined, the term adequately explains the commission's meaning when it has used the term in the performance standards. Tilson suggested that the commission should include a statement as to normal condensation in explanation of the performance standard stated in subsection (a)(2) that closed doors and windows should not allow excessive moisture. The commission has not made a change as a result of the comment because the suggested language does not add meaning to the standard as proposed.

Section 304.18(a)(3) states that window and door glass shall not be broken as a result of construction activities. Similarly §304.18(a)(4) provides that window and door screens shall not be torn or damaged as a result of construction activities. Bothell expressed concern that if such a defect was not noted when the home was transferred from the builder to the buyer, the buyer may claim that damage caused by the homeowner should be repair by the builder. HADD expressed concern that glass may crack due to stress and that the use of the phrase "due to construction activities" might preclude an appropriate repair. As discussed above, "construction activities" are those actions taken by or at the direction of the builder or its employees, agents or subcontractors. The commission believes this phrase as it is used in this section and other proposed performance standards provides adequate coverage for the builder from unscrupulous homeowners and for the homeowner for defects resulting from the builder's actions.

Section 304.18(a)(6) assures that door and window locks and latches shall close securely and shall not be loose or rattle. Although Eberwine suggested different language for this performance standard, the commission finds that its proposed text offers the same standard that doors, windows and their hardware shall close securely and shall not be loose or rattle.

In the remainder of §304.18(a), the commission received comments on proposed explanatory language and maintenance suggestions. The commission has deleted these subsections for the reasons stated earlier on similar proposed sections.

Subsection (b) of 304.18 addresses performance standards for windows. HADD offered a list of possible defects that the commission could add. The commission believes that all of the situations described are covered by currently proposed sections.

Subsection (c) of 304.18 provides performance standards for doors of various types. Section 304.18(c)(1) states that sliding doors and door screens shall stay on track. VBA, GSABA , BCSHBA and Parker all suggested that the performance standard would be better stated if it made clear that the performance expectation is for sliding doors and screens in normal use. However, all of the standards presume conditions of normal residential use.

With regard to the clearing of the bottom of an interior door and the floor, as set forth in §304.18(c)(2), VBA, GSABA and Parker suggested that the commission refer to the original floor covering as opposed to the floor. The commission agrees that if a party adds a new floor covering after the builder has installed flooring, the resulting decrease in space may not be adequate and may create a situation in which the space between the door and the floor no longer meet the performance standard. Accordingly, the commission has revised the subsection as suggested. Eberwine offered that the commission should add the requirement that the space should meet the measurement standards or "as required to maintain proper air flow..." However, the suggested language would add an unacceptable element of uncertainty and subjectivity into an objective standard that the commission declines to adopt.

Section 304.18(d) sets forth performance standards for garage doors. Tilson and Stark both sought clarification for §304.18(d)(2) to be assured that the standard as written could not be read to require the installation of garage door openers. The commission's intent was to state a standard for operability if a garage door with opener is installed. Therefore, the commission has revised the section to clarify that intent.

The commission has also reduced the allowance for a gap around a garage door from 3/4 of an inch to one-half of an inch to address consumer concerns voiced in comments received.

For § 304.18(d)(5), Eberwine suggested that the commission add language regarding the operation of the garage door, including that the door shall remain in place at any open position and that the door shall operate smoothly and without interruption. The commission finds that the suggested changes will improve the standard, so has revised the sections accordingly.

Section 304.19 lays out the performance standards for interior flooring other than finished concrete floors, which are addressed in §304.19(c) of this section. Stark offered improved language for the performance standard stated in §304.19(b) regarding carpet. The commission agrees that the suggested language that carpet "lay flat and be securely fastened" not only improves subsection (b)(1) but eliminates the need for (b)(2) and (b)(3). The commission made those changes and thereby addressed issues raised by others regarding subsection (b)(2).

Section 304.19(c)(1) states that finished slabs that are located in living spaces that are not otherwise designed for drainage shall not have pits, depressions or unevenness that equals or exceeds 3/8 of an inch in any 32 inch measurement. Although several builder representatives raised the question of an exception for specialty features that may incorporate pits or depressions, the commission finds that the exclusion contained in subchapter A for specialty features addresses the issue of intentionally incorporated pits, depression or unevenness.

Section 304.19(c)(2) provides that finished concrete floors in living spaces shall not have cracks or separations equal to or in excess of 1/8 of an inch in width or 1/16 of an inch in vertical displacement. Tilson suggested that the 1/16 of an inch standard for vertical displacement should be changed to 1/8 of an inch to match the standard for concrete slabs in living spaces that are not the finished floor surface. The commission disagrees because concrete slabs that are covered by another floor covering can have a greater allowance because of the buffer of the floor covering. Eberwine and HADD both expressed concern that the 1/8 of an inch width for cracks or separations is too great. However, the commission finds that the standard is reasonable for the properties inherent in concrete.

Section 304.19(d) sets forth the performance standards for wood flooring. Several commenters noted that the proposed standard for humps and ridges in finished wood flooring does not correspond with the standard for subflooring. Many also pointed out that distressed wood floors are currently in vogue and often do not meet this standard as a specialty feature. All suggested that the standards should be the same. The commission concurs and has changed the text to provide that wood floors should not have unevenness, humps or depressions that equal or exceed a measurement of 3/8 of an inch in any 32-inch direction within any room.

In §304.19(d)(3), the stated performance standard is that wood flooring shall not have open joints or separations that exceed 1/8 of an inch. Eberwine and HADD have suggested that 1/16 of an inch is a more appropriate standard. However, the commission has determined that due to the properties of wood flooring when exposed to varying degrees of humidity, 1/8 of an inch is a better standard.

Section 304.19(d)(3)(B) on wood flooring also provides an exclusion from the performance standard for non-hardwood species that contain greater moisture and may shrink after installation and structural wood flooring that has been designed to serve as the finished floor. The standard contains a caveat that the builder must inform the homebuyer of the peculiar characteristics of this type flooring. Eberwine suggested that the caveat also include that the builder must provide the homeowner this information prior to contract signing. The commission agrees that this is a good addition to the proposed text.

Section 304.19(e) states the performance standards for vinyl flooring. Paragraph (1) provides that vinyl flooring must be installed square to the most visible wall and shall not vary by 1/8 of an inch or more in any six-foot run. VBA, Parker, Lennar and Stark all recommend that the measurement should be a 1/4 of an inch in a 32-inch horizontal measurement because the allowance for a bow in the wall is 1/4 inch in any 32 inch horizontal measurement. Since the vinyl flooring is likely to be measured from the wall, those commenting suggest that the standard should be the same. Miller states that the industry standard for installation is that the flooring is to be square with the longest wall. Tilson and Streetman both recommended that the measurement should be greater than 1/4 of an inch in a six foot run, 3/8 and 1/2 of an inch respectively. The commission agrees that the wall bow standard will affect the measurement for the vinyl flooring, so it has revised the standard to comport with the wall bow standard. However, the commission believes that it is more aesthetically pleasing to square the flooring with the most visible wall and not the longest.

With regard to pattern alignment in vinyl flooring, the commission standard is that the pattern shall be aligned in an amount less than 1/8 of an inch. Eberwine suggested that the standard should be 1/16 of an inch, but the commission has determined that the 1/8 standard is more reasonable.

The commission has also determined that vinyl flooring shall not have depressions equal to exceeding one-half of an inch in any six-foot run. Although several commented that the vinyl flooring standards should be the same as the concrete slab standard for the depth of depressions, the commission does not agree. Subfloors of concrete can accept a leveling compound prior to the floor covering that will reduce the degree of depressions in the surface. For that reason, the commission declines to accept the suggestions of VBA, Parker or Stark regarding §304.19(e)(4).

Finally, with regard to vinyl flooring, §304.19(e)(10) provides that a seam in vinyl flooring shall not have a separation that equals or exceeds 1/16 of an inch in width. It further provides that where dissimilar materials abut vinyl flooring, the gap shall not equal or exceed 1/8 of an inch. Eberwine asserts that there should be no separation at seams in vinyl flooring and that gaps adjacent to dissimilar materials should be 1/16 of an inch. The commission disagrees because the suggested installation standards would have an impact on affordable housing unequal to the benefit.

Section 304.20 contains the performance standards for hard surfaces, including ceramic tile, flagstone, marble, granite, slate, quarry tile, finished concrete or other had surface materials.

Subsection (a) discusses the performance standards for these materials generally, regardless of their application. Paragraph (1) of subsection (a) provides that construction activities shall not create cracked or broken hard surfaces. Eberwine suggests that the commission add language specifically addressing the instance of poor surface preparation, but the commission does not agree with the suggestion. Although poor substrate preparation may be a factor that causes broken or cracked hard surfaces, it is not the only cause of such a construction defect.

Subsection (a)(6) of §304.20 address the displacement at a joint between two adjacent hard surfaces and sets the performance standard at not greater than 1/16 of an inch. GSABA, Lennar and BCSHBA expressed concern that trim pieces adjacent to hard surfaces would vary greater than 1/16 of an inch. The commission agrees and adopts the revised language offered.

Subsection (a)(8) provides that hard surface countertops must be level to within 1/4 of an inch in any six-foot run. Although Tilson asserted that the standard was too stringent, the commission finds that it is readily achievable.

Section 304.20(c) has the performance standards specifically for concrete countertops. Paragraph (1) states the standard for pits and depressions that shall not equal or exceed 1/8 of an inch in any 32-inch measurement. Paragraph (2) states that such countertops shall not have cracks or separations equal or exceeding 1/16 of an inch in width or 1/64 of an inch in vertical displacement. Tilson commented that the standards should allow depression of up to 1/4 of an inch and cracks of 1/8 of an inch and displacement of 1/16 of an inch. HADD conversely suggested that concrete countertops should have no cracks. The commission's proposed standard acknowledges that concrete is subject to minor cracking, but it also recognizes that concrete countertops as easily poured and leveled. Therefore, the commission has not revised the standard as a result of the comments received.

Tilson pointed out that there is no need for §304.20(c)(6) regarding the levelness of a concrete countertop because the issue is covered by §304.20(a)(8), which expresses the same standard for hard surfaces, including finished concrete. The point is well-taken and the commission has deleted the duplicative section.

Section 304.21, which addresses performance standards for painting, staining and wall coverings has been revised to reflect comments already discussed, such as the definition of the term "excessive," use of the term "normal light" in lieu of "natural light" and the deletion of unnecessary explanatory comments. Furthermore the standards stated in §304.21 reflect the limited period of the warranty for paint, stain and wall coverings but also reflect the reality that exposure to elements at varying rates can affect the performance of these materials. Therefore, although the commission received stakeholder comments on paint, varnish and wall coverings as proposed in §§304.21(a), 304.21(b) and 304.21(c), none of the comments raised issues or resulted in a change to the proposed text other than the issues and revisions previously discussed.

Section 304.22 states the performance standards for plumbing that are within the one-year workmanship and materials warranty period. HADD listed a number of issues that it felt needed to be covered in this section; however, all of those items listed are either construction issues covered by adherence to IRC and other plumbing standards or are covered elsewhere in this chapter. Subsection (a)(1) states that plumbing fixtures shall not have chips, cracks, dents or scratches due to construction activities. Although Tilson recommended adding a proviso that such blemishes were acceptable if not visible from three feet away in normal lighting conditions, the commission disagrees. Assuming that new appliances and fixtures are installed in accordance with §304.2(a)(5)(A), a homebuyer's reasonable expectation is that the product will not be marred as a result of the builder's actions.

Several of the performance standards in §304.22(a) include exclusionary provisions for tarnished or damaged plumbing fixture finishes that have been marred by factors beyond the builder's control, such as the use of corrosive cleaning methods or the chemical content of the water supply. Eberwine suggested that the commission require the builder to test the

compatibility of products installed with the water that comes into the home. The commission finds that such a requirement is not reasonable and would place an undue burden on the builder.

Plumbing fixtures with stoppers shall operate properly and retain water, per §304.22(a)(6). VBA, GSABA and Parker commented that pop-up stoppers are not designed to retain water indefinitely and that seepage occurs; therefore, these stakeholders suggested inclusion of the caveat that such stoppers shall operate as to meet manufacturer's specifications. The commission agrees that the suggested language adds clarity to the standard.

Subsection 304.22(a)(9) states that tubs and shower pans shall not crack. Eberwine offered that a shower "pan" is different from a shower "base." He offered new language but only that the remedy of repair, which is proposed to be replacement of the failed part, be replacement of the tub or shower. The commission finds that the change would not be consistent with the stated remedy of repair in other sections and declines to make the revision offered.

Section 304.22(b) sets forth one-year performance standards for plumbing pipes and vents. Although Eberwine submitted suggested language revisions, his offerings did not improve the sections addressed.

Sections 304.23 and 304.24 provide the one-year performance standards for heating, cooling and ventilation parts and electrical systems and fixtures that are not a part of the delivery systems covered under subchapter C. Throughout these two sections the commission only received comments on issues already discussed, such as the definition of the term "excessive," use of the terms "construction activities" and "normal light" and the deletion of unnecessary explanatory comments. The commission has revised the language in accordance with its findings on those comments as previously explained. The commission also received comments similar to others discussed before suggesting the addition of language that reiterates performance in accordance with manufacturer's specifications, which the commission has declined to include for the reasons discussed earlier.

Section 304.25 sets out the performance standards expected for interior trim work. Comments and revisions not already addressed include the suggestions by VBA, Parker and BCSHBA that subsection (b) regarding performance standards for shelving should be revised. The proposed text states that the length of a closet rod shall not be shorter than the actual length between the end supports in an amount equal to or exceeding 1/4 of an inch. Those who provided comments suggested that the standards should provide that the closet rod should extend at least two-thirds into the support bracket at each end. The commenters felt that this would offer assured support for a load bearing rod. However, the commission has determined that the suggested language does not provide the same objectivity for compliance with the standard; therefore, it has not revised this section as a result of these comments.

The commission deleted proposed §304.25(a)(5) related to interior trim in a closet to address consumer concerns regarding aesthetics. Section 304.25(a)(4) now addresses all trim, regardless of its placement in a closet.

Section 304.26 states standards for mirrors, interior glass, and shower doors. TAB and Little commented that a shower door is not water tight; and therefore, the performance standard in §304.26(c), that a shower door shall not leak, could not be achieved if the homeowner sprayed water directly at the door. The commission finds that under normal use, the performance standard is achievable.

Section 304.27 regarding performance standards for hardware and iron work has been revised to delete maintenance suggestions that the commission will address in separate guidelines for homeowners. In addition, the commission received comments from Parker and VBA that the performance standard that interior ironwork will not rust should be modified to add "unless the finish is installed as a design feature." The commission feels that this issue is already covered by the exclusion in subchapter A for specialty features. Therefore, the commission has not adopted the suggested language.

Section 304.28 sets out performance standards for countertops and backsplashes. For countertops generally, the performance standard for levelness is that a countertop must be level to within 1/4 of an inch in a six-foot run. Tilson asserted that the standard was too difficult to achieve because of the cumulative variations for levelness in foundations, cabinetry and countertops. However, the commission has determined that the standard is reasonable and achievable without undue added expense for construction.

Tilson made the same comment for the performance standard requiring that countertops not bow or warp in an amount equal to or exceeding 1/16 of an inch per linear foot. For that standard, Tilson suggested that the better measurement is 1/8 of an inch per linear foot. Again, the commission has determined that the proposed standard is both reasonable and achievable without unreasonably increasing the cost of construction.

The performance standards for fireplaces are included in §304.29. GSABA suggested that in the subsection that requires that a fireplace draw properly, the commission should add "when operated in accordance with manufacturer's specifications." For manufactured products, warranty provisions generally require that those products be operated in accordance with specification in order to receive the benefit of the warranty. Therefore, the commission has determined that the suggested language is not necessary to clarify the standard. In addition to the deletion of explanatory language within the standards for fireplaces, the commission has revised this section as a result of a comment received from Eberwine.

Eberwine noted that the standard allowance for a chimney to separate from the main structure in an amount less than one-half inch in a ten foot vertical measurement may create a situation in which a chimney is separated from the main structure up to one and a half inches in a thirty foot home. Eberwine expressed concern that this would create an issue of structural integrity. The commission has determined that since this standard is about external chimneys, and the gaps between adjacent materials are addressed elsewhere in the standards, this section is unnecessary. Accordingly, the commission has deleted it.

Section 304.30 provides performance standards for irrigation systems. GSABA suggested that these standards should not be adopted. The commission has determined that if an irrigation system is installed, the proposed standards are reasonable performance standards that do not add significantly, if at all, to the cost of construction. The commission did revise the standard to make clear that it is not requiring that irrigation systems be installed, but that the standards apply if an irrigation system is installed by the builder. GSABA also suggested that subsection (b), which addresses water spray from a properly installed irrigation system, should be revised to state that water coverage must be "substantially" complete and that water must not spray "excessively" on unintended areas. GSABA stated that there is no way to keep water spray from unintended areas. The commission disagrees. Sprinkler heads must be positioned such that areas that will be damaged by water are not sprayed when the system is in operation.

Section 304.31 states performance standards for fencing. Subsection (a) as proposed provides that fences shall not lean in excess of 7.5% out of vertical. However, Lennar and Stark both suggested different measurements out of concern that the proposed standard allows excessive leaning. The commission revised the standard to provide that a fence shall not lean more than two inches out of plumb due to construction activities.

Performance standards for yard grading are covered in §304.32. Although the proposed standard references the IRC, both Stark and Lennar commented that the IRC is not particularly instructive on the topic. Lennar suggested that reference to the HUD standards might be preferable because those standards offer more direction. Proper drainage is an important feature that affects foundation stability. Therefore, the commission has determined that it is better to direct builders to use grading and drainage standards either as promulgated in the IRC or other governmental regulations. In paragraph (a)(2) of this section, Eberwine suggested that it is better to require the homeowner to "maintain" the drainage pattern as opposed to "preserving" it. The commission accepted the suggestion.

In §304.33, the commission has provided performance standards for pest control. The standard provides that eave returns, truss blocks and other attic and roof vent openings shall not permit rodents, vermin, birds and other similar pests into the home or attic space. GSABA stated that including eave returns would conflict with the IRC, but the commission could not find that conflict. Little and TAB pointed out that there is no opening small enough to keep ants, roaches and other "vermin" out. Therefore, the commission removed the term "vermin." Eberwine offered a grammatical correction, which the commission has incorporated.

Subchapter C provides the performance standards for plumbing, electrical, heating and air-conditioning delivery systems subject to a minimum warranty period of two years.

Parish submitted written comments regarding §304.50(a). He suggested that the section should state that a builder is not responsible for the energy provider's (power company's) inadequate lines or transformer voltage spikes or surges that could cause lights to dim or light bulbs to blow out. The commission agrees with the substance of the comment but feels that the issue is adequately covered.

Tilson commented on §304.50(d)(3) and suggested that this paragraph be removed completely. The commission agrees that the proper placement of this paragraph is within subchapter B and has moved it accordingly.

Section 304.51 sets forth the standards for plumbing delivery systems. Tilson suggested that §304.51(a)(1)(A) should be deleted because the builder should be responsible for installation in accordance with the Code and if a water pipe freezes, it should not be the builder's responsibility. TAB commented that this paragraph should be revised to include "that was not installed in accordance with the applicable code" after "If a water pipe...". The commission agrees that temperature and outside/inside weather is largely outside of the builder's control. However, the builder is responsible for installing and insulating water pipes in accordance with the Code, so the additional language is not necessary. If a pipe is not installed and insulated in accordance with the Code, it is considered a construction defect.

Subsection 304.51(a)(4) provides that water pressure shall not exceed 80 pounds per square inch in any part of the water supply system located inside the home. The IRC provides that minimum static pressure at the building entrance for either a public or private water supply system is 40 pounds per square inch, which is repeated in the standard. The proposed performance standard also provides that if the water supply system does not deliver water to the building at the required minimum static pressure, the builder is not responsible for water pressure variations originating from the water supply source. However, Poage asserted that §304.51(a)(4)(A) should require a builder to provide a regulator to regulate overpressure from the water supply source. The commission does not agree. The installation of a water pressure regulator after the entrance of the water into the house is not a necessity in most instances. Therefore, addition of a regulator may only become a necessity if the water pressure exceeds 80 pounds per square inch as per the standard. The proposed standard also stated that if water pressure within the home is excessively high or low, the builder is required to take action to bring the variance within the standard. Tilson commented that this paragraph should be completely rephrased to clarify that the builder is not responsible for low water pressure entering a home from the water supply. The commission agrees that the builder is not responsible for water pressure that does not meet the minimum static pressure when entering the home from the supply source. Accordingly, this paragraph has been modified to remove the term "low".

Section 304.52 covers the performance standards for heating, air-conditioning and ventilation systems. Although Poage commented that a reference to the Code and manufacturer's specifications should be included in §304.52, the requirement that construction meet Code specifications and that manufacturer's specifications be met for installation of manufactured consumer products are covered in subchapter A. HADD commented that §304.52(b)(1) should be revised to replace 68 degrees with 72 degrees because 68 degrees is too low. The commission disagrees because the temperature stated in the standard is consistent with the ASHRAE guidelines. HADD also commented that the 4-degree temperature range proposed in §304.52(b)(1)(C) is too wide a variance. The commission agrees that without modification the

standard is not clear. Accordingly, the commission has modified the subsection, which is now found at §304.52(b)(1)(B) to provide that the temperatures may vary up to 4-degrees Fahrenheit between rooms, so long as the temperatures meet the standard stated in §304.52(b)(1).

Subsection 304.52(b)(2) provides that an air-conditioning system shall produce an inside temperature of at most 78-degrees Fahrenheit under the local outdoor summer design conditions as specified in the Code. HADD complains that 78 degrees Fahrenheit is too high. However, the proposed standard meets the ASHRAE standards; therefore, the commission has not modified the subsection as a result of the comment. Foster commented that the tolerance of a 4-degree variance between rooms is too broad in §304.52(b)(2)(C). The commission declines modification because the 4-degree variance is consistent with the ASHRAE guidelines. However, like the standard above in subsection 304.52(b)(1)(B), the commission has added the caveat that the temperature shall not vary between rooms greater than the standard set forth in §304.52(b)(2). The commission also added this caveat to §304.52(b)(3). Larkins suggested that the commission use the Air Conditioning Contractors Association guidelines for performance standards on cooling issues and measurements. The commission has determined that the ASHRAE standards are more appropriate for statewide performance standards. Larkins also commented that the 4-degree variance between rooms is vague. However, the commission finds that the modification it has made as a result of comments discussed above addresses this issue. Henderson commented that §304.52(d)(3) should be revised to delete the phrase "the percentage permitted by ANSI/ASHRAE Standard." Henderson notes that the IRC provides a sufficient objective standard regarding sealing of ductwork and the loss factors for forced-air distribution systems. The commission agrees that the deletion will provide further clarity to the section and has deleted the reference to the ANSI/ASRAE standards and has added the objective standard that ductwork shall not leak in excess of the standards set by Code.

Subchapter D states the performance standards for foundations and other structural components of a home. Harwell commented that "Foundations and" should be deleted from the title of the subsection due to redundancy. The commission agrees and the title has been modified accordingly.

Poage commented that the builder should be required to provide the homeowner with a grid showing the foundation and/or floor elevations of the residence taken when the residence is substantially complete. The commission has fully addressed this issue by the definition of "original construction" in subchapter A and that definition has been incorporated into this subchapter.

Grissom commented that subchapter D should be modified so that the State of Texas does not specify prescriptive performance standards but instead defers to a competent group of professional engineers active in the profession to provide such details. The commission has determined that construction defects in slab foundations should be evaluated using the guidelines promulgated by the Texas Section of the American Society of Civil Engineers (2002) (ASCE Guidelines) to permit an evaluation based on an objective standard, which is in keeping with the legislative intent of the Act. Grissom asserts that limiting tilt to ".05 degrees" in any direction is too restrictive and a deflection ratio of L/360 is too loose. However, the commission finds that the measurements it has put forth are consistent with the prevailing engineering consensus on performance standards for slab foundations. Houston made a similar comment but he also referred to design standards used by engineers. The commission's intent is to develop objective performance standards used for evaluation of foundation performance post-construction, not to address design standards that should be followed pre-construction. Accordingly, the commission has not made changes as a result of Grissom's or Houston's comments.

TAB expressed concern that the remedy as stated in each subsection of§304.100 in which the commission has stated that if a lack of compliance with a stated standard exists, the builder shall take such action as is necessary to bring the variance into compliance with the standard—or similar words—is too vague as to what is expected on the part of the builder. For the sake of clarity, TAB has suggested that the language be modified to require the builder to pursue the appropriate remedial measure as described in Section 7 of the ASCE Guidelines. Bonded

Builders provided the same comment. The commission agrees that the suggested revision will provide better guidance and has adopted TAB's suggestion and a similar suggestion made by Pierry.

Subsection (a) of §304.100 states that slab foundations should be evaluated using the guidelines promulgated by the Texas Section of the American Society of Civil Engineers (2002) (ASCE Guidelines). Harwell commented that this paragraph should be rephrased so that the format would be more consistent with the structural standards. Bonded Builders and Pierry offered similar comments. The commission agrees and has modified the paragraph as suggested by Harwell.

HADD commented that there was no need for the commission to add extra definitions or other criteria to the ASCE Guidelines. The commission used the ASCE Guidelines to create an objective standard for evaluating slab foundation performance. The commission's additional criteria provide information for the third-party inspector who must evaluate a claim of a defective foundation.

Harwell offered that the stated standard for deflection should reference the definition of deflection in the ASCE Guidelines. GSABA also offered a definition for "deflection." However, the commission finds that "deflection" is a term of art that needs no further definition and the suggested additional language does not add clarity to the proposed text.

TAB commented that §304.100(a)(1)(A) should be revised to tie together the symptoms of distress found in Section 5 of the ASCE Guidelines with the building and performance standards set forth by the commission in subchapters B and C. TAB believes that the change is necessary because, in the absence of this link between the two standards, there may be a finding of a violation of this standard without real evidence of a structural problem in a home. The commission disagrees with TAB's suggested reference to the performance standards in subchapters B and C because this paragraph is to be used in evaluating performance of foundations, which is not determined by workmanship and materials performance.

Eberwine also commented on §304.100(a)(1)(A), suggesting that the reference to L/360 should be supplemented with "or the equivalent of this degree of deflection." He based his suggestion on concern that the proposed language fails to consider a home that is constructed with materials or components that are damaged or otherwise compromised by slab deflection that does not exceed the limits of deflection. Pierry suggested language that also addressed the situation Eberwine describes. The commission has modified the paragraph to comport with Pierry's suggested language.

In §304.100(a)(1)(A) the commission had proposed that a construction defect would exist if deflection exceeded L/360 and there existed a combination of two or more associated symptoms of distress. The commission has revised the standard such that deflection exceeding L/360 accompanied by more than one symptom of distress would be evidence of a construction defect. This change addresses HADD's comment on the number of symptoms of distress. Little also commented that the paragraph should be revised for better clarity; however, Little's suggested language was not accepted because the commission has modified the paragraph as addressed above.

Harwell recommended changes to §304.100(a)(1)(B) to add clarity that are the same changes he suggested for revising the definition of "original construction" such that evaluations will be based on elevations taken at an approximate rate of at least one elevation per 100 square feet, subject to obstructions. The commission adopted the modifications in the definition of "original construction" and has incorporated them again in this section. Stark pointed out that word "and" should be deleted from the end of the sentence in this subpart of paragraph (1) because that terminology would require that all three conditions identified in paragraph (1) exist. Based on other modifications to this section and the commission's determination that §304.100(a)(1)(B) as proposed did not state a performance standard, the commission has deleted the proposed section.

Section 304.100(a)(1)(C) as proposed provided that a slab foundation shall not exhibit tilt greater than a one-half of one percent change from the original construction elevations that result in actual observable physical damage to the components of the home identifiable in subchapters B and C. Harwell suggested that the language be changed such that "the slab shall not move after construction in a tilting mode in excess of one percent from the original elevations resulting in actual observable physical damage to the components of the home identifiable in subchapter B and subchapter C of this chapter." GSABA, Bonded Builders, TAB and Little made similar comments. Stark commented that in a pure tilt situation, actual physical damage to a home may not be observed even if a slab tilted beyond reasonable expectations that affect usage of the home. Eberwine offered a comment similar to Stark's. Houston expressed concern that one-half of one percent tilt is too liberal a standard under current achievable performance standards with regard to fill settlement. The commission has determined that Harwell's suggested language regarding the one percent tilt from the original construction elevations best expresses the appropriate standard regarding movement. Other recommended changes, that there be no requirement of actual physical damage to the home as a result of tilt and that the physical damage must rise to the level of violating the performance standards in subchapters B and C, are rejected. One percent tilt from the original construction elevations, considering the revisions to the definition of that term, is sufficient to protect a homeowner from a house that is tilted to the degree that it would affect functionality of the home. In addition, subchapter D provided performance standards for the foundation and performance of the structural components is not dependent upon a defect in workmanship and materials. Also, the commission has deleted the references to subchapters B and C in this paragraph for the reasons stated previously.

The subsection on slab foundations also provides that if measurements and associated symptoms of distress show that a slab foundation does not meet the deflection and tilt standards stated, the builder is required to bring the slab into compliance. As discussed previously, the language regarding the remedy has been revised for clarity. Still others commented that use of the connector "and" would require a slab to exhibit both deflection *and* tilt in order to be defective. The commission has changed the "and" to an "or" to reflect its intent. Eberwine commented that "and associated symptoms of distress" should be deleted because the builder can simply repair the "symptoms" and comply with the standard. The commission believes that the modifications resulting from TAB's suggested changes to the remedy will address this issue. Harwell suggested that the commission should reference remedial measures contained in the parties' warranty agreement, if any. However, if parties have an agreement with terms that provide greater protection than the commission's adopted provisions for limited warranty and performance standards, the Act provides that the agreement will supersede the adopted provisions. HADD commented that there is no requirement to record the original tilt or original deflection, which the commission discussed earlier in subchapter A regarding the definition of "original construction elevations". Although there is no requirement that original construction elevations be recorded, if the builder does not have original construction elevations available then a home is presumed level + or - 0.75 of an inch over the length of the foundation thereby creating a reasonable base line for evaluation. Therefore, no additional revision is warranted as a result of HADD's comment.

Subsection (b) lays out the performance standards for floor over pier and beam foundations. Houston again commented that floor deflection tolerance of L/360 is unacceptable. The commission declines revision for reasons expressed above. Harwell offered similar revisions to this performance standard as he offered for slab foundations. The commission has modified the section to incorporate those modifications it adopted previously for purposes of consistency. GSABA's suggestion that the phrase "provided the conditions are not the result of homeowner's actions as described in subchapters A, B or C" be added is rejected because the issue has been taken care of by the adoption of language suggested by TAB and Pierry regarding remedial measures. Eberwine commented that "the equivalent of" be added before L/360. Again, revisions already adopted by the commission address the situation raised by Eberwine's suggestion.

Regarding floor over pier and beam foundations, Pierry commented regarding §304.100(b)(1)(B) that the word "move" should be replaced with "deflect" and the paragraph be rephrased for clarity. The commission agrees and has modified the paragraph in accordance with the suggestion.

Pierry also commented on §304.100(b)(2)(B) regarding load bearing components of a home. He made a suggested change to the remedy language that the phrase "repair, reinforce or replace such load bearing component to restore the structural integrity of the home or the performance of the affected structural system" should be added. The commission agrees and has modified the section accordingly. The commission has also revised the language regarding the appropriate remedy of repair in other paragraphs as suggested by Pierry.

HADD commented that the phrase "home resulting in actual observable physical damage to the home identifiable in Subchapter B and Subchapter C of this chapter" should be deleted. The commission has agreed here and elsewhere in subchapter D and has made the suggested deletion.

Eberwine commented that in §§304.100(b)(3)(A) and 304.100(b)(3)(B) a builder can simply repair only the "actual observable physical damage." The commission has addressed this comment as discussed above. Eberwine also commented that §304.100(b)(3)(A) does not address circumstances of deflection while a home is under construction. The commission's jurisdiction arises after the warranty has become effective, which is generally post-construction. If a home has actual observable physical damage prior to purchase, the buyer may or may not make the decision to accept the home as built.

Comments were received about §304.100(b)(4), damage to structural components. Eberwine suggested adding the phrase "or if the structural component is modified or otherwise damaged in excess of, or in violation of, the manufacturer's specifications to paragraph (B)". The commission has not made a modification as a result of this comment because the performance standards provide for installation in accordance with manufacturer's specifications. Harwell suggested that the performance standard require a damaged structural component to "materially" compromise the structural integrity or performance of the system. The commission has not adopted this language because use of the term "materially" interjects a level of subjectivity that the commission wishes to avoid.

Pierry commented that §304.100(b)(4)(B) should be revised to include the phrase "repair, reinforce or replace such load bearing component to restore the structural integrity of the home or the performance of the affected structural system". For reasons addressed above, the commission has revised the remedy language in this section and others.

As proposed §304.100(c)(5)(A) provides that structural component must not separate from a supporting member in excess of 3/4 of an inch or such that it compromises the structural integrity or performance of the system. Houston commented that a structural component should not separate from a supporting member in excess of 3/4 of an inch regardless of whether it compromises the structural integrity of the system. Pierry commented that this paragraph should be revised to replace "in excess of" with "more than". The commission agrees with the suggested change and made it in both subparts A and B.

TAB commented on §304.100(b)(5)(B) and suggested that the second "is" be deleted for readability. The commission agrees and has revised accordingly. Pierry offered the same language changes regarding remedies as before that the commission has addressed and incorporated into revisions.

Regarding § §304.100(b)(6)(A) and 304.100(b)(6)(B) Harwell asserted again that the performance standard should require a "material" compromise of the structural integrity of a system. The commission declines to make this change for the reason given above.

HADD suggested that the subchapter D does not address certain conditions it described as hot foundations, inadequate drainage, damage caused by foundation failure, wet foundations, foundation chipping, a foundation not built according to specifications, post tension foundation

failures and organic material under foundation. The commission has determined that all of the defects HADD has mentioned are covered in chapter 304. HADD uses the term "consequential damages," which are not within the purview of the Act. Therefore, the commission did not include the issue in this chapter. However, in subchapter A the commission has addressed the builder's responsibility to repair any damage to components of the home caused by a construction defect.

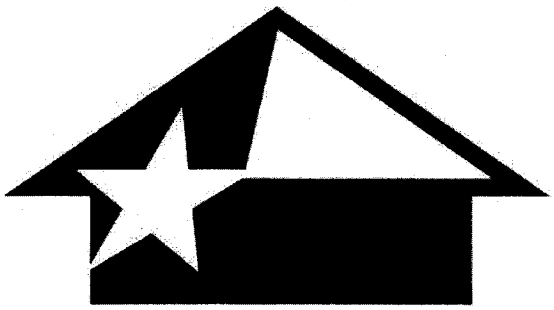
Some general comments were received that did not reference a particular section. BCSHBA and VBA commented that the performance standards are stringent and may impact the costs of home building. The commission considered issues of increased construction costs when developing the proposed standards. Costs of home building may increase somewhat for those builders that do not currently build to the performance standards adopted. However, the commission has determined that the performance standards promulgated balance the potential for increased costs with the need for the building of affordable homes in Texas. Other general comments received were considered in adopting this chapter if the subject matter of the comment was within the jurisdiction of the commission and the purview of this chapter on limited warranties and building and performance standards.

Vint commented that "mold prevention" products are available to eliminate mold growth within energy efficient walls and other water sensitive areas of a home. Vint recommended use of a particular product; however, the commission does not endorse particular commercial products for use in home construction or maintenance. The commission has left flexibility in the statements regarding the builder's responsibilities to repair to provide opportunities for builders and inspectors to use their professional judgment in determining an acceptable method of repair when a construction defect is observed.

No-Burn commented that there are non-toxic fire retardants that have no harmful side effects to humans or pets and no adverse effect on wood. Again, the commission does not endorse any particular commercial products or upgraded material for use in home construction.

Cross Reference to Statutes: Title 16, Property Code ch. 426 and §§408.001 and 430.001

No other statutes, articles, or codes are affected by the adoption.



Texas Residential Construction Commission

Quality Construction for Texans

LIMITED STATUTORY WARRANTY AND BUILDING AND PERFORMANCE STANDARDS

Effective June 1, 2005

Subchapter A. General Provisions.

§304.1. General Provisions.

(a) Scope.

This chapter describes the minimum standards of performance for the various elements or components of a home as described. Third-party inspectors appointed pursuant to §313.11 of this title will make recommendations for repair or replacement of those elements or components of a home that do not meet these standards during the applicable warranty period based upon the expected level of performance described in these standards for residential construction to which the standards apply. If an element or component of a home is not described particularly in this chapter, the element or component shall be constructed in accordance with any written agreement or, if there is no agreement, in accordance with usual and customary residential construction practices and the element or component shall perform for the purpose for which it is intended for the period of the applicable warranty. All home construction shall comply with applicable Codes.

(b) Effective Date.

The provisions of this chapter shall apply to all applicable residential construction projects that must be registered with the commission pursuant to chapter 303, subchapter B, of this title if the construction commences on or after June 1, 2005. Construction commences on the earlier of the date that the parties enter into an agreement for a transaction governed by the Act or the date that work commences.

(c) Definitions.

The following words and terms when used in this chapter shall have the following meanings, unless the context clearly indicates otherwise.

(1) ***Adverse effect*** -- A tangible condition that substantially impairs the functionality of the habitable areas of the home.

(2) ***Builder Responsibility*** -- A statement of the corrective action required by the builder to repair the construction defect and any other damage resulting from making the required repair. Parties may agree to an alternative remedy.

(3) ***Code*** -- The International Residential Code or, if the context requires, the National Electrical Code.

(4) ***Electrical Standard*** -- a standard contained in the version of the National Electrical Code (NEC), as follows:

(A) for residential construction located in a municipality or the extraterritorial jurisdiction of a municipality, the version of the NEC applicable to electrical aspects of residential construction in the municipality under Local Government Code §214.214 and which is

effective on the date of commencement of construction of the home;

(B) for residential construction located in an unincorporated area not in the extraterritorial jurisdiction of a municipality, the version of the NEC applicable to electrical aspects of residential construction in the municipality that is the county seat of the county in which the construction is located and which is effective on the date of commencement of construction of the home; and

(C) for residential construction located in an unincorporated area in a county that does not contain an incorporated area, the version of the NEC that existed on May 1, 2001.

(5) ***Excessive or excessively*** -- a quantity, amount or degree that exceeds that which is normal, usual or reasonable under the circumstance.

(6) ***Exclusion*** – items, conditions or situations not warranted or not covered by a performance standard.

(7) ***Extreme Weather Condition(s)*** -- weather conditions in excess of or outside of the scope of the design criteria stated or assumed for the circumstance or locale in the Code.

(8) ***The International Residential Code (IRC)*** -- substantial compliance with the non-electrical standards contained in the version of *the IRC for One- and Two-Family Dwellings* published by the International Code Council (ICC) as follows:

(A) for residential construction located in a municipality or the extraterritorial jurisdiction of a municipality, the version of the IRC applicable to non-electrical aspects of residential construction in the municipality under Local Government Code §214.212 and which is effective on the date of commencement of construction of the home;

(B) for residential construction located in an unincorporated area not in the extraterritorial jurisdiction of a municipality, the version of the IRC applicable to non-electrical aspects of residential construction in the municipality that is the county seat of the county in which the construction is located and which is effective on the date of commencement of construction of the home; and

(C) for residential construction located in an unincorporated area in a county that does not contain an incorporated area, the version of the IRC that existed on May 1, 2001.

(9) ***Habitable Area*** -- a living space as defined in §301.1(14) of this title.

(10) ***Homeowner Responsibility*** -- an action required by the homeowner for proper maintenance or care of the home or the element or component of

the home concerned. A homeowner's failure to substantially comply with a stated homeowner responsibility creates an exclusion to the warranty for the performance standard.

(11) ***Major Structural Components*** – the load-bearing portions of the following elements of a home:

(A) Footings and Foundations;

(B) Beams;

(C) Headers;

(D) Girders;

(E) Lintels;

(F) Columns (other than a column that is designed to be cosmetic);

(G) Load-Bearing portions of walls and partitions;

(H) Roof framing systems, to include ceiling framing;

(I) Floor systems; and

(J) Masonry Arches.

(12) ***Manufactured Product*** -- a component of the home that was manufactured away from the site of the home and that was installed in the home without significant modifications to the product as manufactured. Manufactured products commonly installed in residential construction include but are not limited to dishwashers, cook tops, ovens, refrigerators, trash compactors, microwave ovens, kitchen vent fans, central air conditioning coils and compressors, furnace heat exchangers, water heaters, carpet, windows, doors, light fixtures, fireplace inserts, pipes and electrical wires. For purposes of this chapter, a manufactured product includes any component of a home for which the manufacturer provides a warranty, provided that the manufacturer permits transfer of the warranty to the homeowner.

(13) ***Original Construction Elevations*** -- actual elevations of the foundation taken prior to substantial completion of the residential construction project. Such actual elevations shall include elevations of porches and garages if those structures are part of a monolithic foundation. To establish original construction elevations, elevations shall be taken at a rate of approximately one elevation per 100 square feet showing a reference point, subject to obstructions. Each elevation shall describe the floor. If no such actual elevations are taken then the foundation for the habitable areas of the home are presumed to be level +/- 0.75 inch (three-quarters of an inch) over the length of the foundation.

(14) ***Performance Standard(s)*** -- the standard(s) to which a home or an element or component of a home constructed as a part of new home construction or a material improvement or interior renovation must perform.

(15) ***Span*** -- the distance between two supports.

(16) **Substantial Completion** -- the later of:

(A) the stage of construction when a new home, addition, improvement, or alteration to an existing home is sufficiently complete that the home, addition, improvement or alteration can be occupied or used for its intended purpose; or

(B) if required, the issuance of a final certificate of inspection or occupancy by the applicable governmental authority.

(d) Resolving conflicts among standards.

When an inconsistency exists between the Code, manufacturer's instructions and specifications, the standard required by the United States Department of Housing and Urban Development for Federal Housing Administration or Veterans Administration programs, ANSI/ASHRAE Standard (62.2-2003) or the commission-adopted performance standards, the most restrictive requirement shall apply.

§304.2. General Provisions Applicable to all Residential Construction for New Homes, Material Improvements and Interior Renovations.

(a) Builder Responsibilities for Compliance with Performance Standards and Repair Obligations.

(1) Builder's Work. The builder is responsible for all work performed under the direction of the builder for the period of the applicable warranty. The builder is only responsible for construction defects about which the builder receives notice on or before the second anniversary of the date of discovery of the alleged construction defect but in no event later than thirty days following the applicable warranty period stated in §304.3(a) of this subchapter, unless otherwise expressly stated herein.

(2) Repair of a construction defect. Any repair shall be performed in a manner and using such materials and methods as recommended by the third-party inspector in accordance with the inspector's duties under §313.14 of this title and consistent with the Code, the performance standard or in accordance with §304.2(a). In the event a third-party inspector determines that a construction defect is present but the inspector does not make a recommendation as to the procedure or method of repair, then the repair shall be in accordance with usual and customary building practices or as agreed by the parties. If the third-party

inspector's report is appealed, then any repairs shall be performed in a manner and using such materials and methods as recommended by the appellate panel. If the appellate panel does not make a recommendation as to the procedure or method of repair, then the repair shall be made in accordance with the usual and customary business practices or as agreed by the parties.

(3) Repair Condition. In connection with a repair of a construction defect, any repairs performed by the builder will include those components of the home that have to be removed or altered in order to repair the construction defect. Repair shall be made so that the condition is returned to its condition as it existed at the time immediately preceding the construction defect.

(4) Finish. Surfaces altered incident to any repair will be finished or touched up to match the surrounding area as closely as practical. In connection with the repair of finish or surface material, such as paint, wallpaper, flooring or a hard surface, the builder will match the standard and grade as closely as reasonably possible. Builder will attempt to match the finish, but will not be responsible for discontinued patterns or materials, color variations or shade variations. When the surface finish material must be replaced and the original material has been discontinued, the builder is responsible for installing replacement material substantially similar in appearance to the original material.

(5) Manufactured Products. The builder shall install all manufactured products in accordance with the manufacturer's instructions and specifications.

(A) The builder shall use only new manufactured products and parts unless otherwise agreed in writing by the parties. If the builder did not install a manufactured product in accordance with the manufacturer's specifications or use newly manufactured parts as required, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall notify the builder of a known construction defect not later than the second anniversary of the date of discovery of the construction defect or not later than thirty days following the applicable warranty period provided in §304.3(a) of this subchapter.

(6) Specialty Feature. Notwithstanding a performance standard stated in this chapter, a specialty feature, which is work performed or material supplied incident to certain design elements shown on the construction plans and specifications and agreed to in writing by the builder and the homeowner, shall be deemed to be compliant with the performance standards stated in this chapter so long as all items are compliant with the Code.

(b) Exceptions and Exclusions from Builder's Responsibilities.

(1) The builder is not responsible for repair, loss or damage to a component or that part of a component of a home caused by or made worse by any of the following:

(A) Work performed or material supplied incident to construction, modification or repair to the home performed by anyone other than the builder or persons providing work or material at the direction of the builder.

(B) The negligence, improper maintenance, misuse, abuse, failure to follow manufacturer's recommendations, failure to take reasonable action to mitigate damage, failure to take reasonable action to maintain the residence or other action or inaction of anyone other than the builder or persons providing work or material at the direction of the builder.

(C) Failure of the homeowner to comply with the homeowner's responsibilities as set forth in subsection (c) of this section or as may be stated separately elsewhere in this chapter.

(D) Alterations to the grade of the soil that are not in compliance with the Code or applicable governmental regulations.

(E) Normal wear and tear or normal deterioration to any component of the home.

(F) Extreme weather conditions.

(G) Riot, civil commotion, war, terrorism, vandalism, aircraft, vehicle or boat.

(H) Fire, smoke or water damage unless such loss or damage is a direct result of a construction defect.

(I) Change in the underground water table that exerts pressure on, seeps, or leaks under the home, sidewalk, driveway, foundation or other structure or causes subsidence or sinkholes.

(J) Erosion or accretion of soils unless such loss or damage is a direct result of a construction defect.

(K) Insects, birds, rodents, vermin or other wild or domestic animals unless such loss or damage is a direct result of a construction defect.

(L) The quality and potability of water unless caused by a construction defect.

(M) While the home is being used primarily for nonresidential purposes.

(N) Use for which the home or the component of the home was not designed.

(O) Use that exceeds the normal design loads prescribed by the Code or the engineer of record.

(P) Homeowner delay in reporting a known construction defect or failing to take reasonable action necessary to prevent further damage to the home.

(Q) For remodeling projects, improvements, alterations or additions to an existing residence where the performance standard cannot be achieved due to an existing condition.

(R) Abuse or misuse of a home component or manufactured product by anyone other than the builder or persons providing work or material at the direction of the builder.

(2) No Actual Physical Damage. The builder shall not be responsible for any condition that does not result in actual physical damage to the home, including, but not limited to the presence of radon gas, formaldehyde or other pollutants or contaminants, or the presence or effect of mold, mildew, toxic material, or volatile organic compound, unless such condition is a direct result of a construction defect.

(c) Homeowner's Responsibilities.

(1) Home Maintenance. Maintenance of the home and the lot on which the home is located are essential to the proper functioning of the home. The homeowner is responsible for maintenance of the home and the lot on which it is located. The homeowner is responsible for maintenance items described in this paragraph and those maintenance items identified separately in the performance standards set forth in this chapter. Additionally, the homeowner is responsible for ongoing maintenance responsibilities that affect the performance of the home but that may not be expressly stated in this chapter. Such ongoing maintenance responsibilities include, but are not limited to, periodic repainting and resealing of finished surfaces as necessary, caulking for the life of the home, regular maintenance of mechanical systems, regular replacement of HVAC filters, cleaning and proper preservation of grading around the home and drainage systems to allow for the proper drainage of water away from the home.

(2) Manufactured Products. The homeowner shall use and perform periodic maintenance on all manufactured products according to the manufacturer's instructions and specifications. The misuse, abuse, neglect or other failure to follow manufacturer's specifications with regard to manufactured products may void the manufacturer's warranty.

(3) Landscape Planting. The homeowner shall take measures to prevent landscaping materials or plants from contacting the exterior surface of the home and from interfering with the proper drainage of water away from the foundation. The homeowner should not improperly alter the proper drainage pattern or grade of the soil within ten feet of the foundation so that it negatively impacts the home's performance or fails to comply with the Code.

(4) Humidity or Dryness in the Home. The homeowner should take the following actions to prevent excessive moisture accumulation by:

(A) properly using ventilation equipment;

(B) preventing excessive temperature fluctuation; and

(C) taking any other action reasonably necessary to avoid excessive moisture, dampness, humidity or condensation in the home that may lead to damage due to excessive moisture or dryness.

(5) Proper Maintenance and Care of Home Components. The homeowner shall properly maintain each component of the home including proper cleaning, care and upkeep of the home. The homeowner shall use home components for the purposes for which they are intended and shall not damage, misuse or abuse home components.

(6) Self-Help. Upon observation of a circumstance that may cause further damage to the home or a component of the home, the homeowner shall take reasonable action necessary to prevent further damage to the home.

§304.3. Limited Warranties.

(a) ***Warranty periods.*** The minimum warranty periods for residential construction and residential improvements are:

(1) one year for workmanship and materials;

(2) two years for plumbing, electrical, heating, and air-conditioning delivery systems;

(3) ten years for major structural components of the home; and

(4) ten years for the warranty of habitability.

(b) ***Manufactured Product Warranties.***

The builder will assign to the homeowner, without recourse, the manufacturer's warranty for all manufactured products that are covered by a manufacturer's warranty. Any rights that inure to the homeowner provided under a manufacturer's warranty are the obligation of the manufacturer. The builder does not assume any of the obligations of the manufacturer resulting from a manufacturer's warranty, but shall coordinate with the manufacturer, suppliers or

agents to achieve compliance with the performance standard. If the manufacturer does not comply with the manufacturer's warranty within a reasonable period of time, the builder will make the affected condition comply with the performance standard and seek redress from the manufacturer.

(c) **Workmanship and Materials Warranty and Performance Standards.**

Workmanship and materials in residential construction or residential improvements are warranted to perform to the performance standards that are set forth this chapter for the minimum period established in subsection (a) paragraph (1) of this section, unless a greater period of warranty is agreed to by the parties.

(d) **Delivery Systems Warranty and Performance Standards.**

Plumbing, electrical, heating and air-conditioning delivery systems in residential construction and residential improvements shall be warranted to perform to the performance standards that are set forth in this chapter for the minimum period established in subsection (a) paragraph (2) of this section, unless a greater period of warranty is agreed to by the parties.

(e) **Structural Components Warranty and Performance Standards.**

Major structural components in residential construction and residential improvements shall be warranted to perform to the performance standards set forth in this chapter for the minimum period established in subsection (a) paragraph (3) of this section, unless a greater period of warranty is agreed to by the parties.

(f) **Warranty of Habitability.**

(1) All residential construction shall include a warranty of habitability for the minimum period established in subsection (a) paragraph (4) of this section, unless a greater period of warranty is agreed to by the parties.

(2) The warranty of habitability is a builder's obligation to construct a home or a home improvement that:

(A) is in compliance with the performance standards; and

(B) is safe, sanitary and fit for humans to inhabit.

(3) An alleged construction defect under the warranty of habitability must have a direct adverse affect on the habitable areas of the home. The warranty applies to an alleged construction defect that would otherwise have been covered by the limited warranties of §304.3(a)(1) and (2), but arose after the termination of those warranty periods, and the alleged construction defect must not have been discoverable by a reasonable prudent inspection or examination of the home or home improvement within the applicable warranty periods.

(4) A request to participate in the State-sponsored Inspection and Dispute Resolution Process (SIRP) for breach of the warranty of habitability must be filed with the commission within two years following the discovery of the condition but not later than thirty days after the tenth anniversary of the effective date of the warranty as determined by subsection (g) of this section.

(g) **Effective Date of Warranties.**

(1) Unless otherwise provided by a written agreement between the builder and the initial homeowner or by a manufacturer, a warranty period as described in this section for a new home begins on the earlier of the date of occupancy or transfer of title from the builder to the initial homeowner.

(2) Unless otherwise provided by a written agreement between the builder and the homeowner, a warranty period as described in this section for an improvement other than a new home or for a partially built home, which by agreement between the homeowner and the builder, someone other than the builder will complete, begins on the date the improvement is substantially completed or the terms of the construction contract are substantially fulfilled.

(h) **Exclusive Warranties.**

(1) The warranties established by the commission in this chapter supersede all implied warranties for new residential construction or residential improvements that commence on or after the effective date of this chapter.

(2) The warranties established by the commission in this chapter are the only warranties applicable to new residential construction unless a particular warranty is created by a statute that expressly refers to residential construction or residential improvements or is created by any express warranty set forth in writing by the builder.

(i) **Waiver By Contract Prohibited.**

A contract between a builder and a homeowner may not waive or modify to lessen the warranty of habitability or the limited statutory warranties and building and performance standards adopted under this chapter.

Subchapter B. Performance Standards for Components of a Home Subject to a Minimum Warranty of One Year for Workmanship and Materials.

§304.10. Performance Standards for Foundations and Slabs.

(a) **Performance Standards for Raised Floor Foundations or Crawl Spaces.**

(1) A crawl space shall be graded and drained properly to prevent surface run-off from accumulating deeper than two inches in areas 36 inches or larger in diameter. Exterior drainage around perimeter crawl space wall shall not allow water to accumulate within ten feet of the foundation for more than 24 hours after a rain except in a sump that drains other areas.

(A) If the crawl space is not graded or does not drain in accordance with the performance standard stated in paragraph (1) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall not modify improperly the existing grade or allow water from an irrigation system to cause water to accumulate excessively under the foundation. The homeowner shall not allow landscape plantings to interfere with proper drainage away from the foundation. The homeowner shall not use the crawl space for storage of any kind.

(2) Water shall not enter through the basement or crawl space wall or seep through the basement floor.

(A) If water enters the basement or crawl space wall or seeps through the basement floor, the builder shall take such action as is necessary to bring the variance within the standard stated in paragraph (2) of this subsection.

(B) The homeowner shall not modify improperly the existing grade or allow water from an irrigation system to cause water to accumulate excessively near the foundation. The homeowner shall not allow landscape plantings to interfere with proper drainage away from the foundation.

(b) **Performance Standards** for Concrete Slab Foundations, excluding Finished Concrete Floors.

(1) Concrete floor slabs in living spaces that are not otherwise designed with a slope for drainage, such as a laundry room, shall not have excessive pits, depressions or unevenness equal to or exceeding 3/8 of an inch in any 32 inches and shall not have separations or cracks that equal or exceed 1/8 of an inch in width or 1/16 of an inch in vertical displacement. If a concrete floor slab in a living space fails to meet the standard stated

in this paragraph, the builder shall take such action as is necessary to bring the variance within that standard.

(2) Concrete slabs shall not have protruding objects, such as a nail, rebar or wire mesh. If a concrete slab has a protruding object, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(3) A separation in an expansion joint in a concrete slab shall not equal or exceed 1/4 of an inch vertically or one inch horizontally from an adjoining section. If an expansion joint in a concrete slab fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **Performance Standards for Exterior Concrete including Patios,(Stem Walls, Driveways, Stairs or Walkways.**

(1) Concrete corners or edges shall not be damaged excessively due to construction activities. If a concrete corner or edge is damaged excessively, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(2) A crack in exterior concrete shall not cause vertical displacement equal to or in excess of 1/4 of an inch or horizontal separation equal to or excess of 1/4 of an inch.

(A) If an exterior concrete slab is cracked, separated or displaced beyond the standard of performance stated in paragraph (2) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall not over-water surrounding soil or allow the surrounding soil to become excessively dry. The homeowner shall not allow heavy equipment to be placed on the concrete.

(3) The finish on exterior concrete shall not be excessively smooth, so that the surface becomes slippery.

(A) If the finish on exterior concrete is excessively smooth so that the surface becomes slippery, the builder shall take such action as is necessary to bring the variance within the standard stated in paragraph (3) of this subsection.

(B) A concrete surface that has been designed to be smooth is excepted from this performance standard.

(4) Exterior concrete shall not contain a protruding object, such as a nail, rebar or wire mesh. If an exterior concrete surface has a protruding object, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(5) A separation in an expansion joint in an exterior concrete shall not equal or exceed 1/2 of an inch vertically from an adjoining section or one inch horizontally, including joint material. If an expansion joint fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(6) A separation in a control joint shall not equal or exceed 1/4 of an inch vertically or 1/2 of an inch horizontally from an adjoining section. If a control joint fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(7) Concrete stair steepness and dimensions, such as tread width, riser height, landing size and stairway width shall comply with the Code. If the steepness and dimensions of concrete stairs do not comply with the Code, the builder shall take such action as is necessary to bring the variance within the standard for Code compliance.

(8) Handrails shall remain securely attached to concrete stairs. If handrails are not firmly attached to the concrete stairs, the builder shall take such steps necessary as to attach the rails securely.

(9) Concrete stairs or stoops shall not settle or heave in an amount equal to or exceeding 3/8 of an inch. Concrete stairs or stoops shall not separate from the home in an amount equal to or exceeding one inch, including joint material. If the stairs or stoops settle or heave or separate from the home in an amount equal to or exceeding the standard above builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(10) A driveway will not have a negative slope unless due to site conditions, the lot is below the road. If a driveway has a negative slope due to site conditions, it shall have swales or drains properly installed to prevent water from entering into the garage. If a driveway has a negative slope that allows water to enter the garage in normal weather conditions, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(11) Concrete floor slabs in detached garages, carports or porte-cocheres shall not have excessive pits, depressions, deterioration or unevenness. Separations or cracks in these slabs shall not equal or exceed 3/16 of an inch in width, except at expansion joints, or 1/8 of an inch in vertical displacement. If a concrete floor slab in a detached garage, carport or porte-cochere does not meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

§304.11. Performance Standards for Framing.

(a) **Building and Performance Standard for Walls.**

(1) Walls shall not bow or have depressions that equal or exceed 1/4 of an inch out of line within any 32-inch horizontal measurement as measured from the center of the bow or depression or 1/2 of an inch within any eight-foot vertical measurement. If a wall does not meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) Walls shall be level, plumb and square to all adjoining openings or other walls within 3/8 of an inch in any 32-inch measurement. If a wall does not meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) A crack in a beam or a post shall not equal or exceed 1/2 of an inch in width at any point along the length of the crack. If a crack in the beam or post fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(4) A non-structural post or beam shall not have a warp or twist equal or exceeding one inch in eight-feet of length. Warping or twisting shall not damage beam pocket. If a non-structural post or beam fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(5) Exterior sheathing shall not delaminate or swell.

(A) If exterior sheathing delaminates or swells, the builder shall take such action as is necessary to bring the variance within the standard stated in paragraph (5) of this subsection.

(B) The homeowner shall not make penetrations in the exterior finish of a wall that allow moisture to come in contact with the exterior sheathing.

(6) An exterior moisture barrier shall not allow an accumulation of moisture inside the barrier.

(A) If an exterior moisture barrier allows an accumulation of moisture inside the barrier, the builder shall take such action as is necessary to bring the variance within the standard stated in paragraph (6) of this subsection.

(B) The homeowner shall not make penetrations through the exterior moisture barrier that permit the introduction of moisture inside the barrier.

(b) **Performance Standards for Ceilings.**

A ceiling shall not bow or have depressions that equal or exceed 1/2 of an inch out of line within a 32-inch measurement as measured from the center of the bow or depression running parallel with a ceiling joist. If a ceiling has a bow or depression that is greater than the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **Performance Standards for Sub-floors.**

(1) Under normal residential use, the floor shall not make excessive squeaking or popping sounds. If the floor makes excessive squeaking and popping sounds under normal residential use, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(2) Sub-floors shall not delaminate or swell to the extent that it causes observable physical damage to the floor covering or visually affects the appearance of the floor covering. Exposed structural flooring, where the structural flooring is used as the finished flooring, is excluded from the standard stated in this paragraph. If a sub-floor delaminates or swells to the extent that it affects the flooring covering as stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) Sub-flooring shall not have excessive humps, ridges, depressions or slope within any room that equals or exceeds 3/8 of an inch in any 32-inch direction. If the sub-flooring fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(d) **Performance Standards for Stairs.**

(1) Stair steepness and dimensions such as tread width, riser height, landing size and stairway width, shall comply with the Code. If stair steepness and dimensions do not comply with the Code, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(2) Under normal residential use, stairs shall not make excessive squeaking or popping sounds. If stairs make excessive squeaking and popping sounds under normal residential use, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

§304.12. Performance Standards for Drywall.

(a) A drywall surface shall not have a bow or depression that equals or exceeds 1/4 of an inch out of line within any 32-inch horizontal measurement as measured from the center of the bow or depression or 1/2 of an inch within any eight-foot vertical measurement. If a drywall

surface fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(b) A ceiling made of drywall shall not have bows or depressions that equal or exceed 1/2 of an inch out of line within a 32-inch measurement as measured from the center of the bow or depression running parallel with a ceiling joist or within 1/2 of an inch deviation from the plane of the ceiling within any eight-foot measurement. If a drywall ceiling fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(c) A drywall surface shall not have a crack such that any crack equals or exceeds 1/32 of an inch in width at any point along the length of the crack. If a drywall surface has a crack that exceeds the standard in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(d) Crowning at a drywall joint shall not equal or exceed 1/4 of an inch within a twelve-inch measurement centered over the drywall joint. If crowning at a drywall joint exceeds the standards stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard. Crowning occurs when a drywall joint is higher than the plane of the drywall board on each side.

(e) A drywall surface shall not have surface imperfections such as blisters, cracked corner beads, seam lines, excess joint compound or trowel marks that are visible from a distance of six feet or more in normal light. If a drywall surface fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(f) A drywall surface shall not be out of level (horizontal), plumb (vertical) or square (perpendicular at a 90-degree angle) such that there are variations in those measurements to wall or surface edges at any opening, corner, sill, shelf, etc. shall not equal or exceed 3/8 of an inch in any 32-inch measurement along the wall or surface.

(1) If a drywall surface fails to meet the standard stated in subsection (f) of this section, the builder shall take such action as is necessary to bring the variance within the standard.

(2) This standard shall not apply to remodeling projects where existing conditions do not permit the builder to achieve the performance standard. At or about the time of discovery of such a preexisting condition, a remodeler shall notify the homeowner, in writing, of any existing condition that prevents achievement of the standard.

(g) Nails or screws shall not be visible in a drywall surface. If nails or screws are visible, the builder shall take such action as is necessary to bring the variance within the standard.

§304.13. Performance Standards for Insulation.

(a) Insulation shall be installed in the walls, ceilings and floors of a home in accordance with the building plan and specifications and the Code. If the insulation in walls, ceilings or floors is not in accordance with the building plans and specifications and the Code, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(b) Blown insulation in the attic shall not displace or settle so that it reduces the R-value below manufacturer's specifications, the building plans and the Code. If the blown insulation in the attic reduces, settles or is displaced to the extent that the R-value is below the manufacturer's specifications, the building plans and Code, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(c) A gap equal to or in excess of 1/4 of an inch between insulation batts or a gap between insulation batts and framing members is not permitted. If a gap equal to or greater than 1/4 of an inch occurs between insulation batts or a gap occurs between an insulation batt and a framing member, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(d) Insulation shall not cover or block a soffit vent to the extent that it blocks the free flow of air. If the insulation covers or blocks the soffit vent, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

§304.14. Performance Standards for Exterior Siding and Trim.

(a) **Performance Standards for Exterior Siding.**

(1) Exterior siding shall be equally spaced and properly aligned. Horizontal siding shall not equal or exceed 1/2 of an inch off parallel with the bottom course or 1/4 of an inch off parallel with the adjacent course from corner to corner. If siding is misaligned or unevenly spaced and fails to meet the performance standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) Siding shall not gap or bow. A siding end joint shall not have a gap that equals or exceeds 1/4 of an inch in width. Siding end joint gaps shall be caulked. A bow in siding shall not equal or exceed 3/8 of an inch out of line in a 32-inch measurement. If siding has gaps or bows that exceed the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) Nails shall not protrude from the finished surface of siding but nail heads may be visible on some products where allowed by the manufacturer's specifications. If a nail protrudes from the finished surface of siding, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(4) Siding shall not have a nail stain. If siding has a nail stain, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(5) Siding and siding knots shall not become loose or fall off. If siding or siding knots become loose or fall off, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(6) Siding shall not delaminate. If siding fails to comply with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(7) Siding shall not cup in an amount equal to or exceeding 1/4 of an inch in a six-foot run. If siding fails to comply with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(8) Siding shall not have cracks or splits that equal or exceed 1/8 of an inch in width. If siding fails to comply with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(b) **Performance Standards for Exterior Trim.**

(1) A joint between two trim pieces shall not have a separation at the joint equal to or exceeding 1/4 of an inch in width and all trim joints shall be caulked. If there is a separation at a trim joint that fails to comply with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) Exterior trim and eave block shall not warp in an amount equal to or exceeding 1/2 of an inch in an eight-foot run. If exterior trim or eave block warps in excess of the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) Exterior trim and eave block shall not cup in an amount equal to or in excess of a 1/4 of an inch in a six-foot run. If exterior trim or eave block cups in excess of the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(4) Exterior trim and eave block shall not have cracks or splits equal to or in excess of 1/8 of an inch in average width. If exterior trim or eave block has cracks in excess of the standard stated in this paragraph, the builder

shall take such action as is necessary to bring the variance within the standard.

(5) Trim shall not have nails that completely protrude through the finished surface of the trim but nail heads may be visible on some products.

(A) If a nail protrudes from the finished surface of the trim, the builder shall take such action as is necessary to bring the variance within the standard within the standard stated in paragraph (5) of this subsection.

(B) Some products specify that the nails be flush with the trim surface. When these products are used, visible nail heads are not considered protruding nails as long as they are painted over.

(6) Trim shall not have a nail stain. If trim has a nail stain, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

§304.15. Performance Standards for Masonry including Brick, Block and Stone.

(a) **A masonry wall shall not bow in an amount equal to or in excess of one inch when measured from the base to the top of the wall.**

(1) If a masonry wall fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The standard set forth in this subsection does not apply to natural stone products.

(b) **A masonry unit or mortar shall not be broken or loose.** If a masonry unit or mortar fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **A masonry mortar crack shall not equal or exceed 1/8 of an inch in width.** If a crack in masonry mortar fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(d) **A masonry unit or mortar shall not deteriorate**. If a masonry unit or mortar fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(e) **Masonry shall not have dirt, stain or debris on the surface due to construction activities.** If masonry fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(f) **A gap between masonry and adjacent material shall not equal or exceed 1/4 of an inch in average width and all such gaps shall be caulked.** If a gap

between masonry and adjacent material fails to meet the standards stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(g) **Mortar shall not obstruct a functional opening, such as a vent, weep hole or plumbing cleanout.**

(1) If the mortar obstructs a functional opening, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(2) The homeowner shall not put any material into weep holes. Weep holes are an integral part of the wall drainage system and must remain unobstructed.

§304.16. Performance Standards for Stucco.

(a) **Stucco surfaces shall not be excessively bowed, uneven, or wavy.**

(1) If a stucco surface fails to perform as stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) This standard shall not apply to decorative finishes.

(b) **Stucco shall not be broken or loose.** If stucco is broken or loose, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(c) **Stucco shall not have cracks that equal or exceed 1/8 of an inch in width at any point along the length of the crack.**

(1) If the stucco fails to perform as stated in subsection (c) of this section, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The builder shall not be responsible for repairing cracks in stucco caused by the homeowner's actions, including the attachment of devices to the stucco surface, such as, but not limited to, patio covers, plant holders, awnings and hose racks.

(d) **Stucco shall not deteriorate excessively.**

(1) If the stucco deteriorates excessively, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The homeowner shall not allow water from irrigation systems to contact stucco finishes excessively.

(e) **Stucco shall not have dirt, stain or debris on surface due to construction activities.** If the stucco fails to meet the standard stated in this subsection, the

builder shall take such action as is necessary to bring the variance within the standard.

(f) **Stucco surfaces shall not have imperfections that are visible from a distance of six feet under normal lighting conditions that disrupt the overall uniformity of the finished pattern.** If the stucco fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(g) **The lath shall not be exposed.** If the lath is exposed, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(h) **A separation between the stucco joints shall not equal or exceed 1/16 of an inch in width.** If a separation between the stucco joints occurs in excess of the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(i) **A separation between a stucco surface and adjacent material shall not equal or exceed 1/4 of an inch in width and all separations shall be caulked.** If a separation occurs between a stucco surface and adjacent material occurs in excess of the standard stated in this subsection or if such a separation is not caulked, the builder shall take such action as is necessary to bring the variance within the standard.

(j) **Stucco shall not obstruct a functional opening, such as a vent, weep hole or plumbing cleanout.** If stucco obstructs a functional opening, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(k) **Stucco screed shall have a minimum clearance of at least 4 inches above the soil or landscape surface and at least 2 inches above any paved surface.** If the stucco screed clearance does not meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(l) **Exterior Installation Finish Systems (EIFS) stucco screed shall clear any paved or unpaved surface by 6 inches.** If the EIFS stucco screed clearance does not meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

§304.17. Performance Standards for Roofs.

(a) Flashing shall prevent water penetration.

(1) If the flashing fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The builder shall not be responsible for leaks caused by extreme weather.

(b) **The roof shall not leak.**

(1) If the roof fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The builder shall not be responsible for leaks caused by extreme weather.

(3) The homeowner shall perform periodic maintenance to prevent leaks due to build-up of debris, snow or ice. The homeowner shall take such action as is necessary to prevent downspouts and gutters from becoming clogged.

(c) **A vent, louver or other installed attic opening shall not leak.**

(1) If a vent, louver or other installed attic opening fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The builder shall not be responsible for leaks caused by extreme weather.

(d) **A gutter or downspout shall not leak or retain standing water.** After cessation of rainfall, standing water in an unobstructed gutter shall not equal or exceed 1/2 of an inch in depth.

(1) If a gutter or downspout fails to meet the standard in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The builder shall not be responsible for leaks caused by extreme weather.

(3) The homeowner shall maintain and clean gutters and downspouts to prevent buildup of debris or other obstructions.

(e) **Shingles, tiles, metal or other roofing materials shall not become loose or fall off in wind speeds less than those set forth in the manufacturer's specifications.** If the shingles, tiles, metal or other roofing materials fail to meet the standard in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(f) **A skylight shall not leak.** If a skylight fails to meet the standard in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(g) **Water shall drain from a built-up roof within two hours after cessation of rainfall**. The standard does not require that the roof dry completely within the time period. If the built-up roof fails to meet the standard in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(h) **A roof tile shall not be cracked or broken.** No shingle shall be broken so that it detracts from the overall appearance of the home. If roof tiles or shingles fail to meet the standard in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(i) **A pipe, vent, fireplace or other object designed to penetrate the roof shall not be located within the area of roof valley centerline without proper "cricketing" or other Code-approved water diversion methods.** If a pipe, vent, fireplace or other object designed to penetrate the roof is not correctly located as provided in the performance standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(j) **The exterior moisture barrier of the roof shall not allow moisture penetration.**

(1) If the exterior moisture barrier fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The homeowner shall not make penetrations through exterior moisture barrier of the roof.

§304.18. Performance Standards for Doors and Windows.

(a) **Performance Standards for Both Doors and Windows.**

(1) When closed, a door or window shall not allow excessive infiltration of air or dust. If a door or window fails to meet the performance standard stated in this paragraph the builder shall take such action as is necessary to bring the variance within the standard.

(2) When closed, a door or window shall not allow excessive accumulation of moisture inside the door or window.

(A) If a door or window fails to meet the performance standard stated in paragraph (2) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall keep weep holes on windows and doors free of dirt buildup and debris, thereby allowing water to drain properly.

(C) Most door and window assemblies are designed to open, close and weep moisture--allow condensation or minor penetration by the elements to drain outside.

(3) Glass in doors and windows shall not be broken due to improper installation or construction activities. If glass in a window or door is broken

due to improper installation or construction activities, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(4) A screen in a door or window shall fit properly and shall not be torn or damaged due to construction activities. A screen shall not have a gap equal to or exceeding 1/4 of an inch between the screen frame and the window frame. If a screen in a door or window fails to meet the performance standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(5) There shall be no condensation between window and door panes in a sealed insulated glass unit.

(A) If a window or door fails to meet the performance standard stated in paragraph (5) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall not apply a tinted window film or coating to window or door panes in sealed insulated glass units.

(6) A door or window latch or lock shall close securely and shall not be loose or rattle. If a door, window latch or lock fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(7) A door or window shall operate easily and smoothly and shall not require excessive pressure when opening or closing. If a door or window fails to meet the performance standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(8) A door or window shall be painted or stained according to the manufacturers' specifications. If a window or door fails to meet the performance standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(b) **Performance Standards for Windows.**

A double hung window shall not move more than two inches when put in an open position. If a window fails to meet the performance standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **Performance Standards for Doors.**

(1) A sliding door and door screen shall stay on track.

(A) If a sliding door or door screen fails to perform to the standard stated in paragraph (1) of this subsection, builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall clean and lubricate sliding door or door screen hardware as necessary.

(2) The spacing between an interior door bottom and original floor covering, except closet doors, shall not exceed 1.5 inches and shall be at least 1/2 of an inch. The spacing between an interior closet door bottom and original floor covering shall not exceed two inches and shall be at least 1/2 of an inch. If the spacing between a door bottom and the original floor covering does not meet the performance standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) A door shall not delaminate. If a door becomes delaminated, a builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(4) A door panel shall not split so that light from the other side is visible. If a door panel fails to meet the performance standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(5) A door shall open and close without binding. If a door fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(6) A door shall not warp to the extent that it becomes inoperable. A warp in a door panel shall not equal or exceed 1/4 of an inch from original dimension measured vertically, horizontally or diagonally from corner to corner. If a door fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(7) A storm door shall open and close properly and shall fit properly. If a door fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(8) When a door is placed in an open position, it shall remain in the position it was placed, unless the movement is caused by airflow. If a door fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(9) A metal door shall not be dented or scratched due to construction activities. If a metal door fails to comply with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(d) **Performance Standards for Garage Doors.**

(1) A metal garage door shall not be dented or scratched due to construction activities. If a metal garage door fails to comply with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) A garage door opener, if provided, shall operate properly in accordance with manufacturer's specifications.

(A) If a garage door opener fails to perform in accordance with the standard stated in paragraph (2) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) A homeowner shall maintain tracks, rollers and chains and shall not block or bump sensors to electric garage door openers.

(3) A garage door shall not allow excessive water to enter the garage and the gap around the garage door shall not equal or exceed 1/2 of an inch in width. If a garage door allows excessive water to enter the garage or the gap around the garage door equals or exceeds 1/2 of an inch, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(4) A garage door spring shall operate properly and shall not lose appreciable tension, break or be undersized. If a garage door spring fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(5) A garage door shall remain in place at any open position, operate smoothly and not be off track. If a garage door fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

§304.19. Performance Standards for Interior Flooring.

(a) **Performance Standards for Carpet, Vinyl Flooring and Wood Flooring.**

Performance standards for ceramic tile, flagstone, marble, granite, slate, quarry tile other hard surface floors, except finished concrete floors, are located in §304.20 of this subchapter.

(b) **Performance Standards for Carpet.**

(1) Carpet shall not wrinkle and shall remain tight, lay flat and be securely fastened. If the carpet fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) Carpet seams shall be smooth without a gap or overlap. If the carpet fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) Carpet shall not be stained or spotted due to construction activities. If the carpet fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **Performance Standards for Finished Concrete Floor.**

(1) A finished slab, located in a living space that is not otherwise designed for drainage, shall not have pits, depressions or unevenness that equals or exceeds 3/8 of an inch in any 32 inches.

(A) If a finished concrete slab in a living space fails to meet the standard stated in paragraph (1) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) Finished concrete slabs in living spaces that are designed for drainage, such as a laundry room, are excepted from the standards stated in paragraph (1) of this subsection.

(2) Finished concrete slabs in living spaces shall not have separations, including joints, and cracks that equal or exceed 1/8 of an inch in width or 1/16 of an inch in vertical displacement. If a finished concrete slab in a living space fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(d) **Performance Standards for Wood Flooring.**

(1) Wood flooring shall not have excessive humps, depressions or unevenness that equals or exceeds 3/8 of an inch in any 32-inch direction within any room. If wood flooring fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) Wood flooring shall remain securely attached to the foundation or sub-floor unless the wood flooring is designed to be installed without nails, glue, adhesives or fasteners. If wood flooring fails to meet the standards of this, the builder shall take such action as is necessary to bring the variance within the standard.

(3) Wood flooring shall not have open joints and separations that equal or exceed 1/8 of an inch.

(A) If wood flooring fails to meet the standards of paragraph (3) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) These standards do not apply to non-hardwood species that contain greater moisture and may shrink after installation or structural floors that are designed to serve as the finished floor. If the floor is designed as a structural finish floor, the builder must provide a written explanation of the characteristics of that floor to the homeowner prior to the execution of the contract.

(4) Strips of floorboards shall not cup in an amount that equals or exceeds 1/16 of an inch in height in a three-inch distance when measured perpendicular to the length of the board.

(A) If the wood flooring fails to meet the standard stated in paragraph (4) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) This standard does not apply to non-hardwood species that typically shrink after installation or structural floors that are designed to serve as the finished floor. If the floor is designed as a structural finish floor, the builder must provide a written explanation of the characteristics of that floor to the homeowner.

(5) Unless installed as a specialty feature, wood flooring shall not have excessive shade changes or discoloration due to the construction activities of the builder. If the wood floor fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(6) Unless installed as a specialty feature, wood flooring shall not be stained, spotted or scratched due to construction activities of the builder. If wood flooring fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(e) **Performance Standards for Vinyl Flooring.**

(1) Vinyl flooring shall be installed square to the most visible wall and shall not vary by 1/4 of an inch in any six-foot run. If the vinyl flooring fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The seam alignment in vinyl flooring shall not vary such that the pattern is out of alignment in an amount that equals or exceeds 1/8 of an inch. If the vinyl flooring fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) Vinyl flooring shall remain securely attached to the foundation or sub-floor. If the vinyl flooring fails to meet the standard stated in this

paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(4) A vinyl floor shall not have a depression that equals or exceeds 1/2 of an inch in any six-foot run. If a vinyl floor has a depression that exceeds the standard stated in this paragraph and the depression is due to construction activities, the builder shall take such action as is necessary to bring the variance within the standard.

(5) A vinyl floor shall not have a ridge that equals or exceeds 1/2 of an inch when measured as provided in this paragraph. The ridge measurement shall be made by measuring the gap created when a six-foot straight edge is placed tightly three inches on each side of the defect and the gap is measured between the floor and the straight edge at the other end. If a vinyl floor has a ridge that fails to comply with the standard stated in this paragraph and the ridge is due to construction activities, the builder shall take such action as is necessary to bring the variance within the standard.

(6) Vinyl floor shall not be discolored, stained or spotted due to the construction activities of the builder. If the vinyl floor fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(7) Vinyl flooring shall not be scratched, gouged, cut or torn due to construction activities. If the vinyl flooring fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(8) Debris, sub-floor seams, nails and/or screws shall not be detectable under the vinyl floor from a distance of three feet or more in normal light. If the vinyl flooring fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(9) Sub-flooring shall not cause vinyl flooring to rupture. If vinyl flooring fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(10) A seam in vinyl flooring shall not have a separation that equals or exceeds 1/16 of an inch in width. Where dissimilar materials abut, there shall not be a gap equal to or greater than 1/8 of an inch. If vinyl flooring fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

§304.20. Performance Standards for Hard Surfaces, including Ceramic Tile, Flagstone, Marble, Granite, Slate, Quarry Tile, Finished Concrete or Other Hard Surfaces.

(a) **Performance Standards for Hard Surfaces Generally.**

(1) A hard surface shall not break or crack due to construction activities. If a hard surface is cracked or broken due to construction activities, the builder shall take such action as is necessary to bring the variance within the standard.

(2) A hard surface shall remain secured to the substrate. If a hard surface fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) A surface imperfection in floor hard surface shall not be visible from a distance of three feet or more in normal light. A surface imperfection in non-floor hard surface shall not be visible from a distance of two feet or more in normal light. If a hard surface fails to meet the standards stated in this paragraph due to construction activities, the builder shall take such action as is necessary to bring the variance within the standard.

(4) Color variations between field hard surfaces and trim hard surfaces should not vary excessively due to construction activities.

(A) If color variations between field and trim hard surfaces are excessive and are due to construction activities, the builder shall take such action as is necessary to bring the variance within the standard stated in paragraph (4) of this subsection.

(B) Natural products such as flagstone, marble, granite, slate and other quarry tile will have color variation.

(5) Hard surface areas shall not leak. If a hard surface area fails to perform in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(6) The surfaces of two adjacent hard surfaces shall not vary in an amount equal to or exceeding 1/16 of an inch displacement at a joint, with the exception of transition trim pieces. If a joint between two hard surfaces fails to meet the performance standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(7) Hard surface layout or grout line shall not be excessively irregular.

(A) If hard surface layouts or grout lines fail to meet the performance standard stated in paragraph (7) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) Natural products such as flagstone, marble, granite, slate, and other quarry tile will have size variations that may create irregular layouts or grout lines.

(8) Hard surface countertops shall be level to within 1/4 of an inch in any six-foot measurement. If a hard surface countertop is not level to within the

standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(b) Performance Standards for Grout.

(1) Grout shall not crack or deteriorate. If grout fails to meet the performance standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) Grout shall not change shade or discolor excessively due to construction activities. If grout fails to perform to the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(c) Performance Standards for Concrete Countertops.

(1) A concrete countertop shall not have excessive pits, depressions, or unevenness that equal or exceed 1/8 of an inch in any 32-inch measurement. If a concrete countertop fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) A concrete countertop shall not have separations or cracks equal to or exceeding 1/16 of an inch in width or 1/64 of an inch in vertical displacement. If a concrete countertop fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) A finished concrete countertop shall not be stained, spotted or scratched due to construction activities. If a concrete countertop fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(4) A concrete countertop shall not have a chipped edge that extends beyond 1/16 of an inch from the edge of the countertop due to construction activities. If a concrete countertop fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(5) A concrete countertop shall not change shade or discolor excessively due to construction activities. If a concrete countertop fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

§304.21. Performance Standards for Painting, Stain and Wall Coverings.

(a) **Performance Standards for Caulking. Interior caulking shall not deteriorate or crack excessively.**

If the interior caulking fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(b) **Performance Standards for Painting and Stain.**

(1) Paint or stain shall not have excessive color, shade or sheen variation.

(A) If the paint or stain fails to meet the standard stated in paragraph (1) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) This standard shall not apply to stained woodwork.

(2) Paint shall cover all intended surfaces so that unpainted areas shall not show through paint when viewed from a distance of six feet in normal light. If the painting fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) Interior paint or stain shall not deteriorate. If paint or stain fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(4) Exterior paint or stain shall not deteriorate excessively. If paint or stain fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(5) Paint over-spray shall not exist on any surface for which it was not intended. If the paint is sprayed onto a surface for which it was not intended, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(6) Interior varnish, polyurethane or lacquer finish shall not deteriorate. If an interior finish fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard. If an interior finish fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(7) Exterior varnish, polyurethane or lacquer finishes shall not deteriorate excessively.

(A) If an exterior finish fails to meet the standard stated in paragraph (7) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) Exterior varnish, polyurethane or lacquer finishes that are subject to direct sunlight are excluded from this standard.

(8) Interior painted, varnished or finished surface shall not be scratched, dented, nicked or gouged due to construction activities. If interior painted, varnished or finished surfaces fail to meet the standard stated in this

paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(9) A paint product shall perform as represented by the manufacturer to meet manufacturer's specifications for washability and/or scrubability. If the paint product fails to meet the standards of this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **Performance Standards for Wall Coverings.**

(1) A wall covering shall be properly secured to the wall surface and shall not peel or bubble. If a wall covering fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) Pattern repeats in wall coverings shall match. Wall coverings shall be installed square to the most visible wall. Pattern repeats shall not vary in an amount equal to or exceeding 1/4 of an inch in any six-foot run. If the wall covering fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) A wall covering seam shall not separate or gap. If the wall covering fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(4) Lumps or ridges in a wall covering shall not be detectable from a distance of six feet or more in normal light. If the appearance of the wall covering fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(5) Wall coverings shall not be discolored, stained or spotted due to construction activities. If a wall covering fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(6) Wall coverings shall not be scratched, gouged, cut or torn due to construction activities. If a wall covering fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(7) Wall coverings shall perform as represented by the manufacturer to meet manufacturer's specifications for washability and/or scrubability. If a wall covering fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

§304.22. Performance Standards for Plumbing.

(a) **Performance Standards for Plumbing Accessories.**

(1) A fixture surface shall not have a chip, crack, dent or scratch due to construction activities. If a fixture fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) A fixture shall not have tarnish, blemishes or stains unless installed as a specialty feature.

(A) If a fixture fails to meet the standard stated in paragraph (2) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) Fixture finishes that are tarnished, blemished or stained due to high iron, manganese or other mineral content in water are excluded from this standard.

(3) A fixture or fixture fastener shall not corrode.

(A) If a fixture or fixture fastener fails to meet the standards of paragraph (3) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) A builder is not responsible for corrosion caused by factors beyond the manufacturer's or the builder's control, including the homeowner's use of corrosive chemicals or cleaners or corrosion caused by water content.

(4) A decorative gas appliance shall be installed in accordance with manufacturer's specifications and when so installed shall function in accordance with manufacturer's representations. If a decorative gas appliance fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(5) Fixtures shall be secure and not loose.

(A) If a fixture fails to meet the standard stated in paragraph (5) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall not exert excessive force on a fixture.

(6) A fixture stopper shall operate properly and shall retain water in accordance with the manufacturer's specifications. If a fixture stopper fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(7) The toilet equipment shall not allow water to run continuously.

(A) If the toilet equipment fails to meet the standard stated in paragraph (7) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) If toilet equipment allows water to run continuously, the homeowner shall shut off the water supply or take such action as is necessary to avoid damage to the home.

(8) A toilet shall be installed and perform in accordance with the manufacturer's specifications.

(A) If a toilet fails to meet the standard stated in paragraph (8) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) In the event of water spillage, the homeowner shall shut off the water supply and take such action as is necessary to avoid damage to the home.

(9) A tub or shower pan shall not crack. If a tub or shower pan fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(10) A tub or shower pan shall not squeak excessively. If a tub or shower pan fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(11) A water heater shall be installed and secured according to the manufacturer's specifications and the Code. If a water heater fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(12) A waste disposal unit shall be installed and operate according to the manufacturer's specifications. If a waste disposal unit fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(13) A faucet or fixture shall not drip or leak. This standard does not include drips or leaks due to debris or minerals from the water source, unless it is due to construction activities. If a faucet or fixture fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(14) A sump pump shall be installed in accordance with the manufacturer's specifications and shall operate properly when so installed. If a sump pump fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(b) **Performance Standards for Pipes and Vents.**

(1) A sewer gas odor originating from the plumbing system shall not be detectable inside the home under conditions of normal residential use.

(A) If a sewer gas odor is detected inside the home under conditions of normal residential use, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall keep plumbing traps filled with water.

(2) A vent stack shall be free from blockage and shall allow odor to exit the home. If a vent stack fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) A water pipe shall not make excessive noise such as banging or hammering repeatedly.

(A) If a water pipe fails to meet the standard stated in paragraph (3) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) A water pipe subject to expansion or contraction of the pipe as warm or cool water flows through the pipe may cause a "ticking" sound temporarily. The standard stated in paragraph (3) of this subsection does not require a builder to remove all noise attributable to water flow and pipe expansion.

§304.23. Performance Standards for Heating, Cooling and Ventilation.

(a) **Performance Standards for Heating and Cooling.**

(1) A condensation line shall not be obstructed due to construction activities.

(A) If a condensation line fails to meet the standard stated in paragraph (1) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall periodically check for the free flow of condensate (water) from the line and clear the line when necessary.

(2) A drip pan and drain line shall be installed under a horizontal air handler as per the Code.

(A) If a drip pan and drain line fails to meet the standard stated in paragraph (2) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall periodically check for the free flow of condensate (water) from the line and clear the line when necessary.

(3) Insulation shall completely encase the refrigerant line according to Code.

(A) If the refrigerant line insulation fails to meet the standard stated in paragraph (3) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall ensure that insulation on the refrigerant line is not damaged or cut due to home maintenance or landscape work.

(4) An exterior compressor unit shall be installed on a stable pad that supports the unit and is no more than one inch out of level. The bottom of the exterior compressor unit support shall not be below ground level.

(A) If an exterior compressor unit pad or support fails to meet the standards stated in paragraph (4) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall ensure that settlement of the exterior compressor unit pad does not occur due to home maintenance, landscape work or excessive water from irrigation.

(b) **Performance Standards for Venting.**

(1) An appliance shall be vented according to the manufacturer's specifications. If an appliance is not vented in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) Back draft dampers shall be installed and function according to the manufacturer's specifications. If back draft dampers fail to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **Performance Standards for Ductwork. Ductwork shall not make excessive noise.**

(1) If the ductwork fails to meet the standard stated in of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The flow of air, including its velocity, or the expansion of ductwork from heating and cooling may cause "ticking" or "crackling" sounds.

(3) The homeowner shall not place any object on the ductwork.

§304.24. Performance Standards for Electrical Systems and Fixtures.

(a) Excessive air infiltration shall not occur around electrical system components or fixtures. If electrical system components or fixtures fail to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(b) A fixture or trim plate shall not be chipped, cracked, dented or scratched due to construction activities. If a fixture or trim plate fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(c) A fixture or trim plate finish shall not be tarnished, blemished or stained due to construction activities. If a fixture or trim fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(d) A fixture, electrical box or trim plate shall be installed in accordance with the Code and shall be plumb and level. If a fixture, electrical box or trim plate fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(e) Fixtures, such as lights, fans and appliances shall operate properly when installed in accordance with the manufacturer's specifications. The builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(f) A smoke detector shall operate according to the manufacturer's specifications and shall be installed in accordance with the Code. If a smoke detector fails to meet the standards stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(g) An exhaust fan shall operate within the manufacturer's specified noise level. If an exhaust fan fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

§304.25. Performance Standards for Interior Trim.

(a) Performance Standards for Trim.

(1) An interior trim joint separation shall not equal or exceed 1/8 of an inch in width and all joints shall be caulked or puttied. If an interior trim joint fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The interior trim shall not have surface damage, such as scratches, chips, dents, gouges, splits, cracks, warping or cupping that is visible from a distance of six feet or more in normal light due to construction activities. If the interior trim fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) A hammer mark on trim shall not be visible from a distance of six feet or more when viewed in normal light. If the interior trim fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(4) A nail or nail hole in interior trim shall not be visible from a distance of six feet or more when viewed in normal light. If the interior trim fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(b) **Performance Standards for Shelving.** Shelving, rods and end supports shall be installed in accordance with the measurements stated in this subsection. The length of a closet rod shall not be shorter than the actual distance between the end supports in an amount equal to or exceeding 1/4 of an inch and shall be supported by stud-mounted brackets no more than four feet apart. The length of a shelf shall not be shorter than the actual distance between the supporting walls by an amount equal to or exceeding 1/4 of an inch and shall be supported by stud-mounted brackets no more than four feet apart. End supports shall be securely mounted. If the closet rods, shelving or end supports fail to meet the standards stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

§304.26. Performance Standards for Mirrors, Interior Glass and Shower Doors.

(a) A mirror, interior glass or shower door shall not be loose and shall be securely mounted or attached to the supporting surface. Fixtures, such as towel bars or door handles, shall be securely mounted. If a mirror, interior glass, shower door, fixture or component fails to meet the standards stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(b) A mirror, interior glass or shower door shall not be damaged due to construction activities. If a mirror, interior glass or shower door fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(c) A shower door shall not leak. If a shower door fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(d) Imperfections in a mirror or shower door shall not be visible from a distance of two feet or more when viewed in normal light. If a mirror or shower door fails to

meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(e) When opening and closing, a shower door shall operate easily and smoothly without requiring excessive pressure. If a shower door fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

§304.27. Performance Standards for Hardware and Ironwork.

(a) **Performance Standards for Hardware.**

(1) Hardware finishes shall not be tarnished, blemished, corroded or stained due to construction activities, unless the finish is installed as a specialty feature.

(A) If the hardware finish fails to meet the standard stated in paragraph (1) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The builder is not responsible for tarnished, blemished, or stained hardware finishes that have been damaged by factors that are beyond the manufacturer's or the builder's control such as the homeowner's use of abrasive pads or cleaners, harsh chemicals, alcohol, organic solvents or deterioration caused by exposure to outdoor elements such as salt air or humidity.

(2) Hardware shall function properly, without catching, binding or requiring excessive force to operate. If hardware fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) Hardware shall not be scratched, chipped, cracked or dented due to construction activities. If hardware fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(4) Hardware shall be installed securely and shall not be loose.

(A) If hardware fails to meet the standards stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) The homeowner shall not exert excessive force on hardware.

(b) **Performance Standards for Interior Ironwork.**

(1) Interior ironwork shall not rust.

(2) If interior ironwork fails to meet the standard stated in paragraph (1) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(3) The builder is not responsible for ironwork finishes that rust due to factors that are beyond the manufacturer's or the builder's control such as the homeowner's use of abrasive pads or cleaners, harsh chemicals, alcohol, organic solvents or deterioration caused by exposure to humidity.

§304.28. Performance Standards for Countertops and Backsplashes.

(a) **Performance Standards for Countertops and Backsplashes Generally.**

(1) A countertop or backsplash shall be secured to substrate in accordance with manufacturer's specifications. If countertop or backsplash materials are not secured to the substrate in accordance with the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) For non-laminate countertops and backsplashes, the joints between countertop surfaces, between the countertop surface and the backsplash or side-splash and between adjoining backsplash panels may be visible, but shall not separate. If joints between non-laminate surfaces fail to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) Countertops shall be level to within 1/4 of an inch in any six-foot measurement. If a countertop surface fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(4) A countertop surface or edge shall not be damaged, broken, chipped or cracked due to construction activities. If a countertop surface or edge fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(5) A countertop shall not bow or warp in an amount equal to or exceeding 1/16 of an inch per lineal foot. If a countertop fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(b) **Performance Standards for Laminate Countertops and Backsplashes.**

(1) Laminate countertops and backsplashes shall not delaminate and shall remain securely attached to the substrate. Delamination is the separation of the finish surface veneer from the substrate material. If a countertop fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(2) A seam in a laminate countertop or backsplash may be visible but shall not be separated or displaced. If a laminate countertop or backsplash fails to meet the standard stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(3) A surface imperfection in a laminate countertop or a backsplash shall not be visible from a distance of three feet or more when viewed in normal light due to construction activities. If a laminate surface fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

§304.29. Performance Standards for Fireplaces.

(a) **A refractory panel shall not crack or separate.**

(1) If the fireplace refractory panel fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The homeowner shall not use synthetic logs or other materials if not approved by the manufacturer.

(b) **A fireplace door shall operate properly.** Fireplace doors shall meet evenly and shall not be out of alignment from one another in an amount equal to or exceeding 1/8 of an inch in any direction. If a fireplace door fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **A fireplace shall not have a gas leak.** If a fireplace has a gas leak, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(d) **Gas logs shall be positioned in accordance with the manufacturer's specifications.**

(1) If a gas log fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The homeowner shall not incorrectly reposition or relocate the logs after the original placement. The homeowner shall not place the logs in a manner that does not allow the flame to flow through the logs according to the manufacturer's specifications.

(e) **A crack in masonry hearth or facing shall not be equal to or exceed 1/4 of an inch in width.** If the masonry hearth or facing of the fireplace fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(f) **A fireplace or chimney shall draw properly.** If a fireplace or chimney fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(g) **A firebox shall not have excessive water infiltration under normal weather conditions.** If a firebox fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(h) **A fireplace fan shall not exceed the noise level established by the manufacturer's specifications.** If a fireplace fan fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

§304.30. Performance Standards for Irrigation Systems.

(a) **An irrigation system shall not leak, break or clog due to construction activities.** If an irrigation system fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(b) **An irrigation system shall be installed such that sprinkler coverage shall be complete and water shall not spray an unintended area due to construction activities.** If an irrigation system fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **The irrigation system control shall operate in accordance with manufacturer's specifications.**

(1) If an irrigation system fails to operate in accordance with manufacturer's specifications, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(2) The builder shall provide the homeowner with instructions on the operation of the irrigation system at closing.

§304.31. Performance Standards for Fencing.

(a) **A fence shall not fall over and shall not lean in excess of two inches out of plumb due to construction activities.** If the fencing fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(b) **A wood fence board shall not be broken due to construction activities.** Wood fence board shall not become detached from the fence due to construction activities of the builder. If the fencing fails to meet the standards stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(c) **A masonry unit or mortar in a fence shall not be broken or loose.** A crack in a masonry unit shall not occur. A crack in the mortar shall not equal or exceed 1/8 of an inch in width. If a masonry unit or mortar in a fence fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(d) **A masonry wall shall have adequate weep holes in the lowest course as required by the Code to allow seepage to pass through the wall.** If a masonry retaining wall fails to meet the standards of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

§304.32. Performance Standards for Yard Grading.

(a) Yards shall have grades and swales that provide for proper drainage away from the home in accordance with the Code or other governmental regulations.

(1) If the grades or swales fail to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(2) The homeowner shall maintain the drainage pattern and protect the grading contours from erosion, blockage, over-saturation or any other changes.

(b) **Settling or sinking of soil shall not interfere with the drainage patterns of the lot or have a vertical depth of six inches or more.** If the soil fails to meet the standard stated in this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

§304.33. Performance Standards for Pest Control.

Eave returns, truss blocks, attic vents and roof vent openings shall not allow rodents, birds, and other similar pests into home or attic space. If an eave return, truss block, attic vent or roof vent opening that allows rodents, birds, and other similar pests into home or attic space, the builder shall take such action as is necessary to bring the variance within the standard state

Subchapter C. Performance Standards for Plumbing, Electrical, Heating and Air-conditioning Delivery Systems Subject to a Minimum Warranty Period of Two Years.

§304.50. Performance Standards for Electrical Delivery Systems.

(a) Performance Standards for Electrical Wiring.

(1) Electrical wiring installed inside the home shall be installed in accordance with the Code and any other applicable electrical standards and shall function properly from the point of demarcation, as determined by the respective utility.

(A) If electrical wiring inside the home is not functioning properly or is not installed in accordance with the Code and any other applicable electrical standards, the builder shall take such action as is necessary to bring the wiring to the standard of performance required in paragraph (1) of this subsection.

(B) The builder shall not be responsible for utility improvements from the meter/demarcation point to the utility poles or the transformer.

(2) Electrical wiring shall be capable of carrying the designated load as set forth in the Code.

(A) If the electrical wiring fails to carry design load, the builder shall take such action as is necessary to bring the variance within the standard set forth in paragraph (2) of this subsection.

(B) All electrical equipment shall be used for the purposes and/or capacities for which it was designed and in accordance with manufacturer's specifications.

(b) Performance Standards for the Electrical Panel, Breakers and Fuses.

(1) The electrical panel and breakers shall have sufficient capacity to provide electrical service to the home during normal residential usage.

(A) If the electrical panel or breakers do not have sufficient capacity to provide electrical service to the home during normal residential usage, the builder shall take such action as is necessary to bring the variance within the standard set forth in paragraph (1) of this subsection.

(B) The builder is not responsible for electrical service interruptions caused by external conditions such as power surges, circuit overloads and electrical shorts.

(2) The electrical panel and breakers shall have sufficient capacity to provide electrical service to the home during normal residential usage such that a circuit breaker shall not trip and fuses shall not blow repeatedly under normal residential electric usage.

(A) If a circuit breaker repeatedly trips or fuses repeatedly blow under normal residential electric usage, the builder shall take such action as is necessary to bring the variance within the standard set forth in paragraph (2) of this subsection.

(B) The builder is not responsible for circuit breaker trips or blown fuses that have functioned as designed to protect the home from external conditions such as power surges, circuit overloads and shorts.

(c) Performance Standards for Electric Outlets with Ground Fault Interrupters.

(1) Electrical outlets with ground fault interrupters shall be installed and operate in accordance with the Code and manufacturer's specifications.

(A) If ground fault interrupters trip repeatedly under normal residential usage, the builder shall take such action as is necessary to ensure that the electrical outlets with ground fault interrupters are installed in accordance with the Code and manufacturer's instructions and specifications and that they operate properly during normal residential electrical usage.

(B) The homeowner shall not plug appliances that require constant electrical flow, such as refrigerators and freezers, into an outlet with a ground fault interrupter.

(d) Performance Standards for Fixtures, Outlets, Doorbells and Switches.

(1) An outlet, doorbell or switch shall be installed in accordance with the manufacturer's specifications and the Code and shall operate properly when installed in accordance with the manufacturer's specifications and the Code. If an outlet, doorbell or switch is not installed in accordance with the manufacturer's specifications and the Code or does not operate properly when so installed, the builder shall take such action as is necessary to bring the variance within the standard stated in this subsection.

(2) A fixture, electrical box or trim plate shall be installed in accordance with the Code and manufacturer's specifications and shall be properly secured to the supporting surface. If a fixture, electrical box or trim plate is not installed in accordance with the Code and manufacturer's specifications or is not properly secured to the supporting surface, builder shall take such action as is necessary to bring the variance within the standard state in this subsection.

(3) A light shall not dim, flicker or burn out repeatedly under normal circumstances. A lighting circuit shall meet the Code. If a light or a lighting circuit fails to meet the standards stated in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(e) Performance Standards for Wiring or Outlets for Cable Television, Telephone, Ethernet or Other Services.

(1) Wiring or outlets for cable television, telephone, ethernet or other services shall be installed in accordance with the Code and any applicable manufacturer's specifications.

(A) If wiring or outlets for cable television, telephone, ethernet or other services are not installed in accordance with the Code or any applicable manufacturer's specifications, the builder shall take such action as is necessary to bring the variance within the standard set forth in paragraph (1) of this subsection.

(B) A builder is not responsible for the failure of wiring or other utility service connectors or conduits that begin before the point at which the service enters the home.

(2) Wiring or outlets for cable television, telephone, ethernet or other services inside the home or on the home side of the meter/demarcation point shall function properly when installed in accordance with the performance standard in paragraph (1) of this subsection.

(A) If wiring or outlets for cable television, telephone, ethernet or other services are not functioning, the builder shall take such action as is necessary to bring the variance within the standard set forth in paragraph (2) of this subsection.

(B) A builder is not responsible for the failure of wiring or other utility service connectors or conduits that begin before the point at which the service enters the home.

§304.51. Performance Standards for Plumbing Delivery Systems.

(a) Performance Standards for Pipes including Water and Gas Pipes, Sewer and Drain Lines, Fittings and Valves but not including pipes included in a Landscape Irrigation System.

(1) Pipes shall be installed and insulated in accordance with the Code and manufacturer's specifications.

(A) If a water pipe bursts, the builder shall take such action as is necessary to bring the variance within the standard stated in paragraph (1) of this subsection.

(B) The homeowner is responsible for insulating and protecting exterior pipes and hose bibs from freezing weather and for maintaining a reasonable temperature in the home during periods of extremely cold weather. The homeowner is responsible for maintaining a reasonable internal temperature in a home

regardless of whether the home is occupied or unoccupied and for periodically checking to ensure that a reasonable internal temperature is maintained.

(2) A water pipe shall not leak.

(A) If a water pipe is leaking, the builder shall take such action as is necessary to bring the variance within the performance standard stated in paragraph (2) of this subsection.

(B) The homeowner shall shut off water supply immediately if such is required to prevent further damage to the home.

(3) A gas pipe shall not leak, including natural gas, propane or butane gas.

(A) If a gas pipe is leaking, a builder shall take such action as is necessary to bring the variance within the standard stated in paragraph (3) of this subsection.

(B) If a gas pipe is leaking, the homeowner shall shut off the source of the gas if the homeowner can do so safely.

(4) Water pressure shall not exceed 80 pounds per square inch in any part of the water supply system located inside the home. Minimum static pressure at the building entrance for either public or private water service shall be 40 pounds per square inch in any part of the water supply system.

(A) This standard assumes the public or community water supply reaches the home side of the meter at 40 pounds per square inch. The builder is not responsible for water pressure variations originating from the water supply source.

(B) If the water pressure is excessively high, the builder shall take such action as is necessary to bring the variance within the standard stated in paragraph (4) of this subsection.

(5) A sewer, drain, or waste pipe shall not become clogged or stopped up due to construction activities.

(A) The builder shall take such action as is necessary to unclog a sewer, drain or waste pipe that is clogged or stopped up due to construction activities.

(B) The homeowner shall shut off water supply immediately if such is required to prevent damage to the home.

(b) Performance Standards for Individual Wastewater Treatment Systems.

A wastewater treatment system should be capable of properly handling normal flow of household effluent in accordance with the Texas Commission on Environmental Quality requirements.

(1) The builder shall take such action as is necessary for the wastewater treatment system to perform within the standard stated in this subsection.

(2) The builder is not responsible for:

(A) system malfunctions or damage due to the addition of a fixture, equipment, appliance or other source of waste or water into the septic system by a person other than the builder or a person working at the builder's direction; or

(B) malfunctions or limitations in the operation of the system attributed to a design restriction imposed by state, county or local governing agencies; or

(C) malfunctions caused by freezing, soil saturation, soil conditions, changes in ground water table or any other acts of nature.

§304.52. Performance Standards for Heating, Air Conditioning and Ventilation Delivery Systems.

(a) A refrigerant line shall not leak.

(1) If a refrigerant line leaks, the builder shall take such action as is necessary to bring the variance within the standard stated in subsection (a) of this section.

(2) Condensation on a refrigerant line is not a leak.

(b) Performance Standards for Heating and Cooling Functions.

(1) A heating system shall produce an inside temperature of at least 68-degrees Fahrenheit as measured two feet from the outside wall of a room at a height of three feet above the floor under local outdoor winter design conditions as specified in the Code.

(A) If a heating system fails to perform to the standard stated in paragraph (1) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) Temperatures may vary up to 4-degrees Fahrenheit between rooms but no less than the standard set forth above in paragraph (1) of this subsection. The homeowner's changes made to the size or configuration of the home, the heating system or the ductwork shall negate the builder's responsibility to take measures to meet this performance standard.

(2) An air-conditioner system shall produce an inside temperature of at most 78-degrees Fahrenheit as measured in the center of a room at height of five feet above the floor, under local outdoor summer design conditions as specified in the Code.

(A) If the air-conditioner system fails to perform to the standard stated in paragraph (2) of this subsection, the builder shall take such action as is necessary to bring the variance within the standard.

(B) This standard does not apply to evaporative or other alternative cooling systems or if the homeowner makes changes to the size or configuration of the home, the air-conditioning system or the ductwork. Internal temperatures may vary up to 4-degrees Fahrenheit between rooms but no more than the standard set forth above in paragraph (2) of this subsection.

(3) A thermostat reading shall not differ by more than 4-degrees Fahrenheit from the actual room temperature taken at a height of five feet above the floor in the center of the room where the thermostat is located. The stated performance standard is related to the accuracy of the thermostat and not to the performance standard of the room temperature. If the thermostat reading differs more than 4-degrees Fahrenheit from the actual room temperature taken at a height of five feet above the floor in the center of the room where the thermostat is located, the builder shall take such action as is necessary to bring the variance within the standard.

(4) Heating and cooling equipment shall be installed and secured according to the manufacturer's instructions and specification and shall not move excessively. If the heating or cooling equipment is not installed and secured in accordance with manufacturer's instructions and specifications or moves excessively, the builder shall take such action as is necessary to properly install and secure the equipment.

(c) Performance Standards for Vents, Grills or Registers.

(1) A vent, grill or register shall operate easily and smoothly when applying normal operating pressure. If a vent, grill or register does not operate easily and smoothly when applying normal pressure when adjusting, the builder shall repair the vent, grill or register so that it operates with ease of use when applying normal operating pressure.

(2) A vent, grill or register shall be installed in accordance with the Code and manufacturer's instructions and specifications and shall be secured to the underlying surface. If a vent, grill or register is not installed and secured in accordance with the performance standard in this paragraph, the builder shall take such action as is necessary to bring the variance within the standard.

(d) Performance Standards for Ductwork.

(1) Ductwork shall be insulated in unconditioned areas according to Code. If ductwork is not insulated in unconditioned areas in accordance with the Code, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(2) Ductwork shall be secured according to the manufacturer's instructions and specifications and it shall not move excessively. If the ductwork is not secured according to the manufacturer's instructions and specifications or moves excessively, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

(3) Ductwork shall be sealed and shall not separate or leak in excess of the standards set by the Code. If the ductwork is not sealed, is separated or leaks in excess of the standards set by the Code, the builder shall take such action as is necessary to bring the variance within the standard stated in this paragraph.

Subchapter D. Performance Standards for Foundations and Major Structural Components of a Home Subject to a Minimum Warranty Period of Ten Years.

§304.100. Performance Standards for Major Structural Components.

(a) Performance Standards for Slab Foundations.

(1) Slab foundations should not move differentially after they are constructed, such that a tilt or deflection in the slab in excess of the standards defined below arises from post-construction movement. The protocol and standards for evaluating slab foundations shall follow the "Guidelines for the Evaluation and Repair of Residential Foundations" as published by the Texas Section of the American Society of Civil Engineers (2002), hereinafter referred to as the "ASCE Guidelines" with the following modifications:

(A) Overall deflection from the original construction elevations shall be no greater than the overall length over which the deflection occurs divided by 360 (L/360) and must not have more than one associated symptom of distress, as described in Section 5 of the ASCE Guidelines, that results in actual observable physical damage to the home.

(B) The slab shall not deflect after construction in a tilting mode in excess of one percent from the original construction elevations resulting in actual observable physical damage to the components of the home.

(2) If measurements and associated symptoms of distress show that a slab foundation does not meet the deflection or tilt standards stated in

paragraph (1) of this subsection, a third-party inspector's recommendation shall be based on the appropriate remedial measures as described in Section 7 of the ASCE Guidelines.

(b) Performance Standards for Major Structural Components of a Home other than Slab Foundations.

(1) Floor over pier and beam foundations.

(A) A floor over pier and beam foundation shall not deflect more than L/360 from its original construction elevations and have that movement create actual observable physical damage to the components of the home identifiable in Section 5.3 of the ASCE Guidelines.

(B) If a floor over pier and beam foundation deflects more than L/360 from its original construction elevation and the movement has created actual observable physical damage to the components of a home identifiable in Section 5.3 of the ASCE Guidelines, a third-party inspector's recommendation shall be based on applicable remedial measures as described in Section 7 of the ASCE Guidelines.

(2) Structural components.

(A) A defined structural component shall not crack, bow, become distorted or deteriorate, such that it compromises the structural integrity of a home or the performance of a structural system of the home resulting in actual observable physical damage to a component of the home.

(B) If a structural component of a home cracks, bows, is distorted or deteriorates such that it results in actual observable physical damage to a component of the home, the builder shall take such action as is necessary to repair, reinforce or replace such structural component to restore the structural integrity of the home or the performance of the affected structural system.

(3) Deflected structural components.

(A) A structural component shall not deflect more than the ratios allowed by the Code.

(B) If a structural component of the home is deflected more than the ratios allowed by the Code, the builder shall to repair, reinforce or replace such structural component to restore the structural integrity of the home or the performance of the affected structural system.

(4) Damaged structural components.

(A) A structural component shall not be so damaged that it compromises the structural integrity or performance of the affected structural system.

(B) If a structural component is so damaged that it compromises the structural integrity or performance of a structural system of the home, the builder shall take such action as is necessary to repair, reinforce or replace such structural component to restore the structural integrity of the home or the performance of the affected structural system.

(5) Separated structural components.

(A) A structural component shall not separate from a supporting member more than 3/4 of an inch or such that it compromises the structural integrity or performance of the system.

(B) If a structural component is separated from a supporting member more than 3/4 of an inch or separated such that it compromises the structural integrity or performance of a structural system of the home, the builder shall take such action as necessary to repair, reinforce or replace such structural component to re-establish the connection between the structural component and the supporting member and to restore the structural integrity of the home and the performance of the affected structural system.

(6) Non-performing structural components.

(A) A structural component shall function as required by the Code.

(B) If a structural component does not function as required by the Code, the builder shall take such action as is necessary to bring the variance within the standard stated in subparagraph (A) of this paragraph.

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THE ECONOMIC LOSS DOCTRINE: AN OFTEN OVERLOOKED DOCTRINE IN SUBROGATION CASES

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I. Hypothetical

Hypothetical A: Your Company insures Reckless Chemical Company under a standard property policy. Last week, a tank containing hazardous chemicals located on your insured's facility ruptured. It has been determined by "Mickey the Metallurgist" that the tank was defectively manufactured. The tank is a total loss and cannot be salvaged. Your insured's nearby office sustained physical damage, as well as other tanks and equipment located in the vicinity of the spill. The total reserve on the claim is currently $700,000.00.

The tank was manufactured seven years ago by "Mediocre Tank Manufacturers" and delivered to your insured's facility six years ago. The tank came with a warranty limiting liability and disclaiming liability for consequential losses. Specifically, the warranty that accompanied the tank provided that it was the exclusive warranty in lieu of all other warranties, rights or claims in tort, contract, or strict liability, that the manufacturer's liability would not exceed the price allocable to the tank, and that the manufacturer would not be responsible for special or consequential damages.

Can you subrogate against the tank manufacturer? What causes of action are available to you? What defenses will you face? What other factors do you need to consider?

II. History of Economic Loss Doctrine

Historically, negligent tortfeasors were not responsible for purely "economic loss" unless such damages accompanied personal injury or property damage. This bright-line rule became more troublesome as the adoption of strict liability raised the issue of

whether a consumer could recover damages when the only thing damaged was the product itself.

In *East River Steamship Corp. v. Transamerica Delaval, Inc.*, the United States Supreme Court confronted this issue and ultimately held that there is no tort duty to prevent a product from injuring itself.[1] The remedies for that type of loss sound in contract. However, a plaintiff can recover in tort for physical damage the defective product causes to "other property."[2]

In *East River,* the plaintiff contracted with the defendant to design, manufacture, and supervise installation of turbines on four oil-transporting tankers constructed by the plaintiff. When the ships were put into service, the turbines on all four ships malfunctioned due to design and manufacturing defects. Only the products themselves were damaged. In holding that a manufacturer has no duty in tort or strict products-liability to prevent a product from injuring itself, the Court categorized a purely economic loss as one in which "no person or other property is damaged."[3]

Much like the United State Supreme Court, the Texas Supreme Court has been consistent in holding that a plaintiff can recover in tort where collateral property damage exists in addition to damage to the product itself. In *Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.,* the Texas Supreme Court held that in transactions between a seller and buyer, when no physical injury has occurred to persons or other property, injury to the defective product itself is economic loss governed by the Uniform Commercial Code.[4] In *Signal Oil & Gas Co. v. Universal Oil Products,* the Texas Supreme Court held that where collateral property damage exists in addition to damage

to the product itself, the plaintiff can recover in tort.[5] In *Signal*, the plaintiff sued the defendants for property damage and economic loss resulting from an explosion and fire at the plaintiff's refinery. Plaintiff contended, among other things, that an isomax charge heater was defectively manufactured. Plaintiff contended that the defective reactor charge heater not only damaged itself, but also damaged other equipment in the unit, other property in the area, and led to damage and/or loss of product contained within the unit. While the plaintiff failed to obtain the requisite finding to support its strict liability claim, the court held that where collateral property damage exists in addition to damage to the product itself, such damages are recoverable in tort.[6]

III. Recent Texas Cases Addressing the Economic Loss Rule

As previously discussed, the law distinguishes between tort recovery for physical injuries and warranty recovery for economic loss.[7] Where "a product injures a consumer economically and not physically," the consumer may recover under the warranties provided by the Uniform Commercial Code, but not for strict liability in tort.[8] This rationale has been extended to negligence claims involving defective products,[9] as well as to recovery of economic losses in negligence when the loss is the subject matter of a contract between the parties.[10]

Texas courts have repeatedly held though that where collateral damage exists in addition to damage to the product itself, recovery for the collateral damage is recoverable in tort.[11] However, the existence of a tort claim for the loss of "other property" does not transform a contract or warranty claim for damage to the product itself into a tort claim.[12] This point is best illustrated by *Murray v. Ford Motor Co.* In *Murray,* a subrogated carrier and its insured brought suit against Ford for the loss of a

vehicle and personal property that was in the vehicle due to a fire that originated in the vehicle. Ford argued that any claims for negligence or strict liability for loss of the vehicle were barred by the economic loss doctrine.

The subrogated carrier and its insured argued that because personal property was in the vehicle, the economic loss doctrine did not bar recovery in tort for the vehicle, as it "transformed" a contract claim for damage to the product itself into a tort claim. The Court disagreed with this argument, holding that the existence of a tort claim for loss of "other property" does not transform a contract claim for damage to the product itself into a tort claim.[13] However, it was clear from the Court's discussion (as well as from Ford's summary judgment reply) that the economic loss doctrine did not apply to tort claims involving damage to the personal property that was in the vehicle.[14]

Such a distinction obviously raises questions regarding what constitutes "other property" or "collateral damage" in losses involving complex products. In *Saratoga Fishing Co. v. J.M. Martinac & Co.,* the Supreme Court examined the meaning of the phrase "other property." In *Saratoga,* the defendant built a ship and sold it to a co-defendant. The co-defendant added extra equipment—a skiff, a seine net, and various spare parts—and used the ship for tuna fishing. The co-defendant then sold the ship to the plaintiff. Shortly after the sale, the ship caught on fire and sank. While all of the parties in *Saratoga* agreed that the "product itself" was a ship built and outfitted by its original manufacturer, the Court held that extra equipment added to the ship was "other property" for which the plaintiff could recover in tort for its physical loss.[15]

The Texas Supreme Court will soon address this and other related issues, as it recently decided to review *Equistar Chemicals, L.P. v. Dresser-Rand Co.*[16] In *Equistar,* a chemical company (Equistar) brought suit against the supplier of parts for its compressors (Dresser) alleging strict liability, negligence, and breach of warranty. Essentially, Equistar alleged that impellers provided for its gas compressors by Dresser were defective and damaged the compressors.

In an attempt to circumvent the economic loss rule, Equistar argued that the impellers were the "product," and that the compressors were "other property" for which damages were recoverable in tort. The Houston Court of Appeals disagreed, and held that damage to the compressors caused by the impellers was not damage to "other property."[17] In reaching its decision, the court relied on the United States Supreme Court's decision in *East River Steamship* (holding that when a defective turbine component damaged the rest of the turbine, it has not damaged "other property"),[18] and on the Texas Supreme Court's decision in *Mid-Continent* (holding that damage to an entire airplane caused by the failure of one component could not be brought in tort because of the economic loss rule).[19]

One issue of first impression that the Houston Court of Appeals addressed in *Equistar* was whether replacement parts constitute "other property." Noting that other courts have generally not distinguished between new and replacement parts in the economic loss context, the court ultimately held that replacement parts provided by the original seller do not make the original product "other property."[20]

Texas courts have also grappled with the issue of allowing injured parties to sue in tort for economic loss only when there is no contractual privity between the injured party and the tortfeasor. In *Hou-Tex, Inc. v. Landmark Graphics,* a gas and oil company (Hou-Tex) filed suit against a computer software developer (Landmark) after the company's geological contractor chose a poor drilling site. The drilling site was selected in part based on data contained within a computer program owned and licensed by the software developer.

The court noted at the outset that Hou-Tex suffered only economic damages.[21] Given that fact, the Court held that the economic loss rule precluded any duty in tort by Landmark to Houston.[22] The Court reasoned that permitting Hou-Tex to sue Landmark for economic losses would disrupt the risk allocations that Hou-Tex had worked out with its geological contractor, and the risk allocations in Landmark's licensing agreement with product users like the geological contractor.[23] Consequently, Hou-Tex's negligence action was dismissed.[24]

This issue was examined in a slightly different context in *Coastal Conduit & Ditching, Inc. v. Noram Energy Corp.*[25] In *Coastal,* suit was brought against Noram alleging increased expense from Noram's alleged failure to properly identify and mark its utility lines. As in all negligence cases, the threshold issue was whether Noram owed Coastal a duty not to mismark the location of its gas lines or to bury its lines at improper depths in the absence of a contractual relationship or claim for personal injury or property damage.

In holding that Noram had no such duty to Coastal, the court focused on a case from the Amarillo Court of Appeals purportedly addressing this issue.[26] In *Rodriguez v. Carson,* a truck driver who sustained no personal injuries in an accident caused by the defendant's negligence sued for lost wages and commissions after the truck owned by his employer was damaged. The court found that there was no breach of a duty owed to the driver by the defendant with respect to the injury, i.e., the absence of a truck to drive.[27] In other words, because the driver did not sustain personal injuries or damage to personal property (because he had no vested interest in the truck), any obligation with respect to the loss of the vehicle would arise by reason of some relationship or agreement between the driver and his employer.[28]

In following the reasoning of the Amarillo Court of Appeals, the court in *Coastal* declined to follow a minority of jurisdictions that have allowed recovery of purely economic damages on a finding that there was a "foreseeable risk of harm or a foreseeable plaintiff."[29] The court in *Coastal* reasoned that "The foreseeability of economic loss, even when modified by other factors, is a standard that sweeps too broadly in a professional or commercial context, portending liability that is socially harmful in its potential scope and uncertainty."[30] Because there was neither a contractual relationship between Coastal and Noram nor a claim for personal injury or property damage, the court held that there was no corresponding duty and summary judgment in favor of Noram was proper.[31]

III. Conclusion

The economic loss rule and its impact are often ignored when evaluating potential subrogation claims. While this paper does not contain an exhaustive review of the economic loss doctrine, it is nevertheless a good starting point. In sum, subrogation claims involving damage to "products" will likely involve warranty and/or contact claims. If warranty and/or contract claims are the only available avenues of recovery, it is important to review any limited warranties and/or contracts which purport to limit claims and/or damages, as well as to consider the applicable statute of limitations. If the loss also involves damage to other property, viable tort claims may exist for those damages as well. This last scenario is obviously the most desirable scenario, and the one with which you will have the most success in your subrogation claims.

[1] *East River Steamship Corp. v. Transamerica Delaval, Inc.* 476 U.S. 858 (1986).
[2] *Id.* at 867.
[3] *See id.*
[4] *Mid-Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.*, 572 S.W.2d 308, 313 (Tex.1998).
[5] *Signal Oil & Gas Co. v. Universal Oil Products,* 572 S.W.2d 320, 325 (Tex.1978).
[6] *Id.*
[7] *Nobility Homes of Texas, Inc. v. Shivers,* 557 S.W.2d 77, 79 (Tex.1977), *quoting Seely v. White Motor Co.*, 63 Cal.2d 9, 45 Cal.Rptr. 17, 23, 403 P.2d 145, 151 (1965).
[8] *Nobility Homes,* 557 S.W.2d at 79-81.
[9] *See Indelco, Inc. v. Hanson Industries North America—Grove Worldwide,* 967 S.W.2d 931, 932-33 (Tex.App.-Houston [14th Dist.] 1998, pet. denied) (economic loss caused by defective product damaging itself are not recoverable through a suit alleging negligence).
[10] *See Southwestern Bell Tele. Co. v. DeLaney,* 809 S.W.2d 493, 494 (Tex.1991).
[11] *Signal Oil & Gas Co. v. Universal Oil Products,* 572 S.W.2d 320, 325 (Tex.1978).
[12] *Murray v. Ford Motor Co.*, 97 S.W.3d 888, 893 (Tex.App.-Dallas 2003).
[13] *Id.*
[14] *See id.*
[15] *Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875, 884-85 (1997).
[16] *Equistar Chemicals, L.P. v. Dresser-Rand Co.*, 123 S.W.3d 584 (Tex.App.-Hous. [14th Dist.] 2003).
[17] *Id.* at 588.
[18] *East River Steamship,* 476 U.S. 858.
[19] *See Mid-Continent,* 572 S.W.2d at 310-11, 313.
[20] *See Equistar,* 123 S.W.3d at 588.
[21] *Hou-Tex, Inc. v. Landmark Graphics,* 26 S.W.3d 103, 107 (Tex.App.-Houston [14th Dist.] 2000).
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *Coastal Conduit & Ditching, Inc. v. Noram Energy Corp.*, 29 S.W.3d 282 (Tex.App.-Hous. [14th Dist.] 2000).
[26] *See Rodriguez v. Carson,* 519 S.W.2d 214 (Tex.Civ.App.-Amarillo 1975, writ ref'd n.r.e.).
[27] *Id.* at 287.
[28] *Id.*
[29] *See id.* at 288 (*citing e.g., J'Aire Corp. v. Gregory,* 24 Cal.3d 799, 804 (1979).
[30] *See id.* (*citing Local Joint Executive Bd. v. Stern,* 98 Nev. 409 (1982).
[31] *See id.* at 289.

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Hypothetical Pipeline Rupture

Facts

- A large underground pipeline ruptures. The pipeline is owned and operated by Global Pipeline Co. As a result of the rupture, 500,000 gallons of gasoline spill out on to a ranch owned by Texas Cattle Company, Inc. and run off into a nearby creek.

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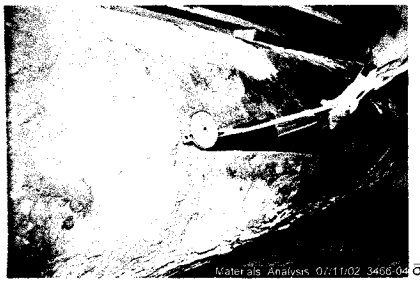
- Digging out around the pipeline reveals a 15 year old 30" steel pipe section. The pipe reveals a gaping rupture along a longitudinal weld seam as well as localized corrosion.



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- The NTSB issues a report suggesting that the rupture resulted from either a defective weld or corrosion or both.
- Global initiates a massive clean up and remediation effort paid for under its liability policy. Texas Cattle bides its time waiting to see how clean up proceeds.
- Meantime, downstream landowners file multiple suits. A subrogation suit to recover the clean up and remediation costs based on the allegedly defective weld seam is contemplated.

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Standing Issues: Who Owns the Claim?

- Often the party undertaking the clean up is a potentially responsible party (Global) and not the Landowner (Texas Catttle)
- Under some states' laws, the right to seek recovery for an injury to real property (the ranch) may be limited to the owner of the property (Texas Cattle)
- Strategies:
  - Acquire the Claim (through Assignment)
  - Enlist the Landowner in the Recovery Action (co-Plaintiff)

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Who paid for Clean-up?

- Costs are often paid under a liability policy
- Significance:
  - Claim for recovery not a "subrogation claim"
  - Rather, the recovery is one for "contribution"
- Issues when seeking contribution:
  - Venue selection
  - Economic Loss Rule
  - Collateral Source Rule
  - Effect of Settling with Landowner

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Venue Selection Issues

- Third Party Claims in General
- Whether to file contribution claims and third party claims in the existing lawsuits; or
- File the product liability claim (against the pipe maker) as a separate case

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Economic Loss Issues

- Basic Rule/Potential Defense
- Damage to Global Pipeline Itself—Barred by Economic Loss Rule
- Damages to the ranch (owned by Texas Cattle but remediated by Global) —Issues
- Lost Profits of Global—Barred by Economic Loss Rule

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Collateral Source Rule

- Basic Rule
- Application to Hypothetical
  - Policy not purchased by Landowner (Texas Cattle)
  - Is the remediation being undertaken by Global (and its insurer) reducing Texas Cattle's claim for damages?
  - Is Global's liability policy a "collateral source?"

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What happens if Global settles with Texas Cattle and proceeds with a contribution claim against the pipe maker?

- In Texas (and various other states) settling tortfeasors cannot seek contribution against non-settling tortfeasors (see multi-jurisdiction survey in hand-out)
- In such states, claim (after settling) may be limited to any injury to the easement
- Enlisting Landowner without settling
  - Non-Waiver of claims/reservation of rights
  - Tolling of statute of limitations
  - Express "non-agreement" regarding settlement
  - Disclosure and waiver of potential conflicts of interest

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Federal Sources of Recovery

- Various federal statutes expressly provide for contribution
  - Oil Pollution Act of 1990
  - Clean Water Act
  - CERCLA
- Issues:
  - Permit federal jurisdiction
  - May require a "triggering event" (i.e., the OPA requires a threat to navigable waters)
  - Co-ordination with defense counsel

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Other Issues

- Product Identification
- Statute of Repose
- Installation/Maintenance Issues
- Authority in charge of clean-up—may pass to state and/or federal agency quickly after spill
- Use of Governmental Reports (i.e. NTSB handles pipeline spills)
- Coordination with Liability Counsel
  - Invoking Federal Statutes
  - Venue and timing of bringing third party claims

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Case Study: Gas Well Blowout

Facts

- May 12, 2001 a gas well blows out in Western Oklahoma. This region is known for its deep, high pressure gas wells
- Plaintiffs are the company who was operating the well and the investors in the well
- Defendants are a down hole float equipment manufacturer located in Houston and its Oklahoma distributor

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Facts (continued)

- Plaintiffs allege the blowout was caused by a failure of the Defendant's float equipment, which was improperly rated for use in this well
- Defendants allege the blowout was caused by the negligence of the Plaintiffs who did not control the blowout, and who also had a duty to investigate the rating for the float equipment before using it in the well

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Making Technology Accessible to the Jury

- Animation

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Making Technology Accessible to the Jury

- Visual Aids
- Glossary

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Hiring the Right Experts

- Blowout cases are largely circumstantial
- Standard of Care
- Mode of Failure
- Metallurgy
- Warnings
- CPA

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Role of Participants in Joint Operating Agreement

- Lead Operator
  - Binds other participants (non operating interests)
  - Primary responsibility for down hole activity
- Non-Operating Interests
  - Check Agreement to see if a cause of action exists against third party agents

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Other Issues

- Agency/Consignment Sale
- Damages: Total Loss, or Partial Loss?
- Chain of Custody

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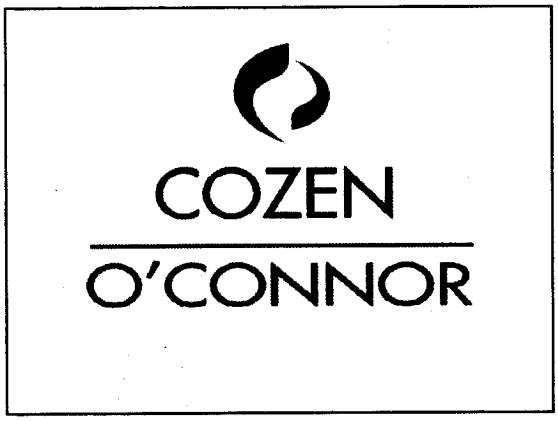
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CONTAINERS OVERBOARD:
THE DARK SIDE OF THE REVOLUTION IN WORLD TRADE
– LEGAL AND PRACTICAL ISSUES INVOLVED IN CONTAINER LOSS CALAMITIES

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CONTAINERS OVERBOARD: THE DARK SIDE OF THE REVOLUTION IN WORLD TRADE—LEGAL AND PRACTICAL ISSUES INVOLVED IN CONTAINER LOSS CALAMITIES

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I. INTRODUCTION—RAPID CHANGES IN THE CONTAINER INDUSTRY

Transportation of goods stowed in shipping containers and carried on the ocean has become a lynchpin of the modern economy. The greatest proportion of container moves occurs from the exporting countries of Asia across the Pacific to North America to the West Coast ports of Los Angeles/Long Beach, Seattle/Tacoma, Oakland, and Vancouver, B. C. Atlantic coast ports in New York/New Jersey, Norfolk, Charleston, and Savannah also do brisk business with both European and Asian exporters to the U.S. Houston's recent efforts to develop an expanded container facility at Bayport demonstrate the demands of the modern economy to transcend the traditional break-bulk activity. The Gulf Coast container market as a whole has kept pace with other areas, expanding at a rate of 9% in 2003 compared to an 8.9% national growth rate[1].

[1] Pacific Shipper, August 9, 2004.

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According to the U.S. Department of Transportation Bureau of Transportation Statistics, in 2001 the total dollar value of all imported cargo transported by sea was $519,607,000,000.[2] The same statistics show that in 2001, 5.5 million containers arrived in the U.S. by a ship from a foreign port.

Container vessels have grown in size on a rapidly accelerating scale in the past few years. In the early 1990's, vessels which were barely able to fit through the Panama Canal were dubbed "Panamax" vessels. In the late 1990's, the first generation of "post-Panamax" container vessels were constructed. These post-Panamax vessels, carrying approximately 4500 TEUs,[3] were designed with the assumption that the economies of scale allowed by increased container capacity outweighed the restrictions posed by the inability to serve old, traditional trade routes. The degree to which this assumption succeeded is demonstrated by the new container vessels currently being constructed, dubbed "super post-Panamax" which carry up to 10,000 TEUs Thus, older and smaller container ships are being retired to coastal and feeder service trades and the behemoths of just a few years ago are suddenly shifted to other routes as well.

Two vessels with catastrophic histories of losing containers, the APL CHINA and the OOCL AMERICA, carried 4,800 and 5344 TEUs, respectively. The magnitude of the

[2] http://www.transtats.bts.gov/. This site, maintained by the Department of Transportation, provides a variety of transportation statistics. The specific statistic for dollar value of water borne imports is revised every five years. The authors assume, with the trade deficit, that the value of imports has risen since 1999, but we have no specific data on current import values.

[3] "TEU" is a unit of measurement for container ship carrying capacity, standing for "Twenty foot Equivalent Units."

losses dwarfed the previous "large" losses from only a few years previous. Studies following the 1998 APL CHINA casualty focused on the new phenomenon of parametric rolling.[4] Clearly the previous "worst case" design criteria for lashing gear underestimated the forces generated on cargo lashing systems in use on larger ships when those vessels encounter adverse weather conditions in the open sea.

Continued developments in the technology of ocean carriage, driven in part by the economics of the industry and its customers, will inevitably result in large scale container losses. These may result from encountering severe conditions at sea but they may also result from other causes such as improper stowage, defective lashing gear, inadequately designed lashing systems, collision, fire, grounding, machinery failure, terrorist attack or any combination of the foregoing. The "bottom line," though, is that larger vessels, carrying more containers, are likely to suffer proportionately larger losses when accidents occur.

II. THE LAWYER'S ROLE

Regardless of the cause, both sides of the admiralty bar will be called when an ocean-going vessel has suffered a major casualty at sea and is going to arrive in port bearing substantial damages to cargo, ship, and personnel. The legal and practical

[4] See France, Treakle & Moore, Head-Sea Parametric Rolling and Its Influence on Container Lashing Systems (Webb Institute 6th International Ship Stability Workshop), reprinted at http://web02.webb-institute.edu/stability/6th_ISSW_Parametric_Roll.pdf.

implications and considerations for the maritime lawyers and their clients are addressed in this paper.

III. BEFORE THE SHIP ARRIVES

As with any assignment, the first duty of the lawyer is to determine the basic question: "who is the client?" Typically the vessel's P & I Club in consultation with the carrier assigns defense counsel but there are a number of separate interests which may be involved. The owner, the operator, and the issuer of the bills of lading may be different. There may be charter agreements involved, whether bareboat, time or slot charters. The charters may (and likely will) contain terms requiring one party to indemnify or insure the other. These clauses may very well contain limitations on their application that are directly implicated by the nature of the cause of the casualty. For example, an owner may be obligated to indemnify a slot charterer against cargo claims unless the loss or damage resulted from heavy weather. Thus, while both would benefit from a successful heavy weather defense against cargo interests, the slot charterer may perceive that its chances of success on a heavy weather defense are low and decide to pursue indemnity against the owner instead – arguing against the owner's heavy weather defense. As such, a single ship carrying many containers may very well play host to parties who are potentially defendants to cargo or other interests, but who are in conflict with each other on key issues.[5]

[5] These circumstances should give rise to early consideration of whether to strategically accept a tender of indemnity despite a strongly held conviction that, e.g., adverse weather was the sole cause of the losses.

The losses may be insured under different or more than one policy depending upon the nature of the loss and the type of cause and insurance coverage. Certain aspects of cargo claims may fall within the collision liability clauses of a hull policy in a both-to-blame collision, whereas others might be covered by the P&I insurer. The damages involved may (and likely will) involve multiple coverages. It is not unusual for a heavily damaged vessel or one carrying heavily damaged cargo to be treated as an actual or potential pollution threat, resulting in the activation of pollution prevention plans. As wreckage is cut away by ship repairers, fires can result, further complicating questions of damage and cause. Defense counsel needs to analyze the risks involved as quickly as possible in order to provide the proper defense—and the proper notifications to other interests from whom indemnity or defense costs may be sought. For example, if there are questions surrounding stowage or the sufficiency of lashing systems, foreign stevedores, design firms, and/or ship builders may need to be placed on notice. Analysis of the risks, though, requires a knowledge of what happened—the lawyer must therefore proceed as

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They should also lead to early consideration of entering into joint litigation agreements so that those parties who are defending can do so and cooperate with each other while preserving the privilege under the so-called common interest doctrine. The common interest doctrine permits parties who have common legal interests to share and exchange attorney-client privileged information without that information losing its protected status. See Restatement (Third) of the Law Governing Lawyers § 126 (Proposed Final Draft No. 1, 1996). The doctrine is a relatively new legal development that has been adopted to varying degrees by most state and federal courts. See generally James M. Fischer, The Attorney-Client Privilege Meets the Common Interest Arrangement: Protecting Confidences While Exchanging Information For Mutual Gain, 16 Rev. Litig. 631, 632 (1997) [hereinafter "Fischer, Common Interest Arrangement"]. The trend in state and federal courts is to adopt the common interest doctrine thereby extending the attorney-client privilege. See Lawrence D. Stone et al., The Common Interest or Pooled Information Privilege, 20 Colo. Law. 225, 225 (1991).

quickly as possible to investigate the underlying facts surrounding the casualty. Yet any investigation of the facts must be guided by the potential uses of the information and the issues likely to be confronted in a casualty of this anticipated magnitude. These legal issues are touched upon below.

IV. CONSIDERATION OF LEGAL ISSUES

A. LIMITATION OF LIABILITY

A shipowner may be able to limit liability in the United States to the value of the vessel at the conclusion of the voyage and freights then pending. 46 App. U.S.C. § 183(a). Because a container ship is an "oceangoing" vessel, any injury or death claimants could require the owner to include $420 per ton in the limitation fund. 46 App. U.S.C. § 183(b). Those additional funds would be available for death and injury claimants only. Obviously, if the vessel was a total loss, the limitation fund could be quite small. If not a total loss, then the fund will vary depending upon market value of the vessel less the cost of repairs. The ability of a vessel owner to successfully limit its liability depends upon whether the cause of the loss was within the owner's privity or knowledge. 46 App. U.S.C. § 183(a). If the value of the multiple claims to be expected following a major cargo casualty will exceed the post-voyage value of the vessel plus pending freight, then an owner will probably want to take advantage of the opportunity to seek limitation.[6] Doing so will at

[6] Major container losses at sea also require consideration of alternative forums. It is beyond the scope of this paper to address the issue in the detail it deserves, but it merits noting that a vessel owner who seeks

least impose a "concursus" of all claims into a single federal court where, in theory, they can be adjudicated more efficiently.

Because most of the major container losses occur during an ocean crossing, there is the possibility that a party will seek to apply the law of a foreign country, including that county's limitation of liability laws. Thus, there must be some consideration of choice of law as well as of most convenient forum for overall resolution of the dispute.

Choice of law may be influenced by whether the cause of the loss is a collision or something else. In collision cases, the rules are clear and of long-standing application. Any collision in the territorial waters of a country will be governed by the laws of that country. Ishizaki Kisen Company, Ltd. v. U.S., 510 F.2d 875, 879 (9th Cir. 1975). A corollary to the rule requiring application of the law of the nation in whose waters a collision occurs is the rule requiring application of the law of the flag in cases arising out of collisions on the high seas between vessels of the same flag. See, The Belgenland, 114 U.S. 355, 369 (1885). Under U.S. law a collision on the high seas between vessels of

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limitation of liability does not forfeit, by doing so, the right to ask the court to dismiss all claims filed in the limitation proceedings under the doctrine of *forum non conveniens.* See Complaint of Geophysical Service, Inc., 590 F.Supp. 1346 (S.D.Tex. 1984)(finding Canadian law applied and dismissing Canadian seamen's injury claims filed in charterer's limitation action); see also In Re American President Lines Limitation Proceedings, 1995 AMC 2296 (S.D.N.Y. 1995) (considering but rejecting owner's *forum non conveniens* argument in limitation proceedings filed in U.S. after both-to-blame collision in Korean waters). If litigation is proceeds too far in a limitation action, however, the court may decide in its discretion that the right to a different forum has been waived. See In re Deleas Shipping (Hyundai Seattle), 1996 AMC 434 (W.D. Wa., 1995). Therefore, early notice of an intent to seek *forum non conveniens* dismissal should be provided in the limitation complaint and the motion should be filed as soon as possible after the date for filing claims has passed. One of the authors has recently obtained forum non conveniens dismissal of claims filed in limitation proceedings arising out of a collision in foreign waters. The case, entitled LaFarge Limitation Proceedings, is pending publication in AMC.

different flags is governed by the law of the forum in which the litigation is pending. Alkmeon Naviera, S.A. v. M/V Marina L, 633 F.2d 789, 793 (9th Cir. 1980).

In other cases, the maritime courts of the United States apply an "interest" analysis first recognized by Lauritzen v. Larsen, 345 U.S. 571 (1953) and later elaborated upon by Hellenic Lines Ltd. v. Rhoditis, 398 U.S. 306 (1970); and Romero v. International Term. Operating Co., 358 U.S. 354 (1959). In such cases the courts examine specific, but non-exclusive, factors for purposes of determining what nation has the greatest connection to the casualty.[7]

To further complicate matters, there is a special rule that is employed when determining what nation's law will control various issues in limitation of liability proceedings pending in a U.S. court. In The Norwalk Victory, 336 U.S. 386, 1949 AMC 394, the Supreme Court muddied the choice of law waters and provided the lower courts with an "extraordinarily obscure"[8] invitation to apply foreign law in limitation actions. In that case, the U.S. flag ship NORWALK VICTORY collided with a British vessel in Belgian waters. Cargo interests of the British Ship sued the NORWALK VICTORY in New York.. The shipowner filed a petition to limit its liability.

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[7] Id. at 1274. These factors are (1) the place of the wrongful act; (2) the law of the flag; (3) the allegiance or domicile of the injured seaman; (4) the allegiance of the defendant shipowner; (5) the place of the contract; (6) the inaccessibility of the foreign forum; (7) the law of the forum; and the (8) owner's base of operations. Lauritzen, 345 U.S. at 583-92; Rhoditis, 398 U.S. at 309.

[8] G. Gilmore & C. Black, The Law of Admiralty 941 (2d ed. 1975) (describing The Norwalk Victory).

The issue in the Norwalk Victory was whether the Belgian limitation act or the American act provided the limitation amount.[9] The Court rejected the argument that The Titanic stood for the broad principle that American law always applied to limitation proceedings. Instead, the test was whether the foreign limitation "attaches" to the right to recover. If so, the foreign provision is substantive and, under general legal principles, foreign law would apply.[10] If not, the law is procedural and U.S. law applies.[11] The Court remanded the case for determination of whether the Belgian law was substantive or procedural.

The Norwalk Victory has been subject to substantial criticism since its promulgation.[12] In his well-known treatise, Thomas Schoenbaum argues that limitation statutes are nearly always procedural because they never create liability but merely limit liability.[13] As such, "it is difficult to imagine a case in which the 'limitation attaches to the right.'"

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[9] 1949 AMC at 400. The petitioners argued that Belgian law applied, limiting liability to $325,000. Id. at 395. The claimants countered that American law applied, which limited the amount to approximately $1,000,000. Id.

[10] Id. ("Any other conclusion would disregard the settled principle that, in the absence of some overriding domestic policy translated into law, the right to recover for a tort depends upon and is measured by the law of the place where the tort occurred.")

[11] Id. ("If, on the other hand, the Convention merely provides procedural machinery by which claims otherwise created are brought into concourse and scaled down to their proportionate share of a limited fund, we would respect the equally well settled principle that the forum is not governed by foreign rules of procedure.").

[12] See, e.g., Kenneth H. Volk & Nicholas H. Cobbs, Limitation of Liability, 51 Tul. L. Rev. 953, 981-82 (1977).

[13] Thomas Schoenbaum, Admiralty & Maritime Law § 15-3, at 335 (3d ed. 2001).

B. IS LIMITATION AVAILABLE UNDER U.S. LAW?

More than determining the amount of the limitation fund, the critical issue under U.S. limitation of liability law is whether the owner is entitled to limitation. The Limitation Act provides, in pertinent part:

> The liability of the owner of any vessel . . . for any act, matter, or thing, loss, damage, or forfeiture, done occasioned , or incurred, without the privity or knowledge of such owner or owners, shall not, except in the cases provided for in subsection (b) of this section, exceed the amount or value of the interest of such owner in such vessel, and her freight then pending.

46 U.S.C. app. § 183(a). Application of the statute is a two-step process. First, the court must determine whether, due to negligence or unseaworthiness, the shipowner is liable. In re Hercules Carriers, Inc., 768 F.2d 1558, 1563-64 (11th Cir. 1985). Second, if the shipowner is liable, the court must decide whether the ship owner had knowledge or privity of those acts. Id.; Farrell Lines Inc. v. Jones, 530 F.2d 7 (5th Cir. 1976).

"The shipowner's privity or knowledge is not measured against every fact or act regarding the accident; rather, privity or knowledge is measured against the specific negligent acts or unseaworthy conditions that *actually caused or contributed to the accident*." Suzuki of Orange Park, Inc. v. Shubert, 86 F.3d 1060, 1064 (11th Cir. 1996) (emphasis added, citing Farrell Lines, Inc. v. Jones). The "privity or knowledge" analysis must be considered in light of the individual facts of the case at hand. Coryell v. Phipps, 317 U.S. 406, 411 (1943). The phrase requires "some personal participation of the owner in the fault or negligence which caused or contributed to the loss or injury." Id. A

shipowner has privity or knowledge where he knew or, through a reasonable inspection should have known, of negligent acts or unseaworthy conditions that actually caused or contributed to the accident. Hercules Carriers, 768 F.2d at 1564.[14] The privity and knowledge focus must be on the specific negligent acts that actually caused or contributed to the accident. Unless those specific acts that were causative are within the privity and knowledge of the owner, it should be entitled to limit its liability.

Where a crew member's mistake causes an accident at sea, as long as he was properly trained and supervised, it may constitute a purely operational act for which limitation of liability is routinely made available. See 46 U.S.C. § 192; Petition of Kristie Leigh Enterprises, Inc., 72 F.3d 479, 481-82 (5th Cir. 1996) (owner may limit liability even though operational error by tug captain caused tow to hit fishing boat); Mac Towing, Inc. v. American Com'l Lines, 670 F.2d 543 (5th Cir. 1982) (may limit liability when operational error by tug captain caused collision); Farrell Lines, 530 F.2d 7 (momentary mistake by helmsman was not imputed to privity or knowledge of owners, granting limitation). The law, in recognition of the difficulty an owner has in predicting and preventing operational errors, grants a vessel owner the right to limit its liability.

[14]The warranty of seaworthiness owed by a vessel owner applies only to the crew of the vessel and its cargo. The Caledonia, 157 U.S. 124 (1895). The warranty does not extend to shoreside workers. See In re Sause Bros. Ocean Towing, 1991 AMC 1242, 1247 (D. Or. 1991).

C. DEFENSES AND CAUSES OF ACTION

Most major container loss cases will involve carriage of goods on vessels either coming to the U.S. from a foreign port or en route to a foreign port from the U.S. With modern collision avoidance methods and equipment, collision on the high seas is rarely the cause of a major loss at sea—although collisions in congested areas near Asian ports have continued to occur with surprising frequency. Most cases have involved issues related to the quality of the stow, unusually strong weather, or a combination. Thus, in preparing to investigate, counsel should bear in mind the legal duties and defenses available under the U.S. Carriage of Goods by Sea Act ("COGSA").[15]

Although other liability defenses are listed in COGSA, those most often encountered in major container loss cases involve negligent navigation, perils of the sea, or Act of God. 46 App. U.S.C. § 1304. Investigating a loss, it is important to understand the nature and limitations of the perils of the sea, or, "heavy weather" defense.

"Perils of the sea" are "those perils which are peculiar to the sea, and which are of an extraordinary nature or arise from irresistible force or overwhelming power and which cannot be guarded against by the ordinary exertions of human skill and prudence." R.T. Jones Lumber Co. v. Roen Steamship Co., 270 F.2d 456, 458 (2d Cir. 1959).[16] In other

[15]COGSA will either be compulsorily applicable pursuant to 46 App. U.S.C. § 1312 or will apply by virtue of a so-called "Clause Paramount" in the carrier's bill of lading pursuant to 46 App. U.S.C. § 1307.

[16] See also Steel Coils, Inc. v. M/V Lake Marion, 331 F.3d 422, 435 (5th Cir. 2003) (defining a "peril of the sea" as a danger "of an extraordinary nature or arising from irresistible force or overwhelming power, which

words, the "Peril of the Sea" or "Act of God" defense normally "applies only to events in nature so extraordinary that the history of climatic variations and other conditions in the particular locality affords no reasonable warning of them." Warrior & Gulf Navigation Co. v. United States, 864 F.2d 1550, 1553 (11th Cir. 1989); see Bradley v. The City of Seattle, 160 Wash. 100, 106, 294 P. 554 (1930) ("The act of God which excuses a common carrier from liability must be the immediate and distinct result of providential events, sudden or overwhelming in their character, which human foresight could not foresee." (internal quotations omitted)).

Armed with these, and perhaps many other legal considerations, counsel must prepare to investigate the casualty.

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could not be guarded against by the ordinary exertions of human skill and prudence" (internal quotations omitted)); Eastern Gas & Fuel Associates v. Martin Marine Transp. Co., 190 F.2d 394, 396 (3rd Cir. 1951) (quoting approvingly from a case stating that "the weather must be irresistible, overwhelming, and extraordinary for the particular time of year" to establish the perils of the sea defense); The Cleveco, 154 F.2d 605, 615 (6th Cir. 1946) ("Peril of the sea is something so catastrophic as to triumph over those safeguards by which skillful and vigilant seamen usually bring ship and cargo to port in safety . . . and storms relied upon to explain the loss of a vessel . . . must be shown to have been of extraordinary intensity" (internal citations and quotations omitted)); Sabine Towing Co. v. Brennan, 72 F.2d 490, 493 (5th Cir. 1934) (holding that a storm relied upon to explain the loss of a vessel "must be shown to have been of extraordinary intensity"); The Giulia, 218 F. 744, 746 (2d Cir. 1914) ("Perils of the seas are understood to mean those perils which are peculiar to the sea, and which are of an extraordinary nature or arise from irresistible force or overwhelming power, and which cannot be guarded against by the ordinary exertions of human skill and prudence."); Skandia Ins. Co. v. Star Shipping AS, 173 F. Supp. 2d 1228, 1240 (S.D. Ala. 2001) ("U.S. courts do not find foreseeable risks to be perils of the sea" (internal quotations omitted)); C. Itoh & Co. (America), Inc. v. M/V Hans Leonhardt, 719 F. Supp. 479, 505 (E.D. La. 1989) (defining peril of the sea as "some catastrophic force or event that would not be expected in the area of the voyage, at that time of the year and that could not be reasonably guarded against"); Charlton Hall, 285 F. 640, 642 (S.D.N.Y. 1922) (A peril of the sea is "something so catastrophic as to triumph over those safeguards by which skillful and vigilant seamen usually bring ship and cargo to port in safety."). While not all of the cases cited herein defined "perils of the sea" under the Harter Act, the definition of the phrase is the same under other statutes, as well as under bills of lading and insurance policies. See 2A Benedict on Admiralty § 153, at 15-3.

D. FORUM JURISDICTION CLAUSES

In Vimar Seguros y Reaseguros v. M/V SKY REEFER, 515 U.S. 528, 1995 AMC 1817 (1995), the U.S. Supreme Court stunningly announced that forum jurisdiction clauses for COGSA shipments are valid in foreign forums, whether for arbitration or litigation. The Sky Reefer decision left some unanswered questions which might have limited its application, but later cases, notably Fireman's Fund Ins. Co. v. M/V DSR ATLANTIC, 131 F.3d 1336, 1998 AMC 583 (9th Cir., 1997) have effectively ended those possibilities. Unless and until Congress passes a new COGSA, forum jurisdiction clauses in bills of lading will be generally enforced. It is worth noting that service agreements can (and should) include dispute resolution agreements (arbitration or litigation, including the forum) which are actually negotiated and in such a situation, the service agreement will prevail over the fine print on the reverse side of the bill of lading.

All the forum jurisdiction cases, particularly in an admiralty setting, trace their lineage to The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 92 S.Ct. 1907, 32 L.Ed. 2d 513 (1972) in which the U.S. Supreme Court held that a forum selection clause is "prima facie valid and should be enforced unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances." It went on to say that enforcement is "unreasonable" where it would "contravene a strong public policy of the forum in which suit is brought." This language does allow some room for argument in a particular circumstance—but the courts have not been receptive to carving out exceptions. The

ultimate resolution of the case will in all likelihood occur in the forum designated in the bill of lading—but that does not eliminate the possibility of legal proceedings to enforce discovery in the U.S. District Court nearest the present location of the vessel. With more than one jurisdiction involved, the need for coordination between counsel in multiple arenas becomes critically important.

V. INITIATION OF THE INVESTIGATION

While defense counsel may think she is overwhelmed by a barrage of often conflicting bits of information as she tries to analyze what happened; cargo counsel knows he is already behind in the race to determine what happened. Owner's counsel is usually appointed as soon as the vessel reports the calamity, but cargo counsel may not be retained for several days as the word of the loss gradually gets out. Furthermore, while defense counsel may be besieged by different interests (government, schedulers, longshoremen, cargo interests, cargo counsel, surveyors, insurers, general counsel, media inquiries), he has ready access to the evidence which may tell him what happened.

The cargo counsel, by contrast, cannot contact the crewmembers and at best gets delayed reports of the communications which may have taken place during the voyage. Cargo counsel has fewer distractions because owner's counsel must deal with so many other non-cargo issues but cargo counsel is restricted in access to the evidence, i.e., the ship herself. All parties are on "fast forward" because the ship may rest at its arrival port for only a day or two, depending upon the nature and scope of the damage. Since her time

in port may be compressed, the more advance planning cargo counsel can arrange, the better. Of course as he is trying to make these careful preparations before the ship arrives, he can only guess what really happened to cause the loss.

Cargo counsel is often appointed by the potentially subrogated underwriters who insured the cargo. Although the cargo underwriter may recognize a potential subrogation situation, the right to proceed belongs to the insured until a payment is made under the cargo insurance policy. As long as investigation is proceeding by agreement with the shipowner, the underwriter and its counsel can participate. HOWEVER, if anything needs to be filed in court in advance of an actual subrogated interest, it must be in the name of the insured, not the underwriter—and it needs to be authorized by an employee of the insured (i.e., shipper or consignee) with the proper authority. Because the insured may not be sophisticated in dealing with such losses a knowledgeable and helpful insurance broker can serve a valuable service in expediting communications between the insured and underwriters' counsel.

Often, but not always, the parties involved in major container losses at sea cooperate to a reasonable extent. The vessel owner typically has an important business relationship with the shippers of the damaged cargo and would be hard pressed to refuse a reasonable request for access to the vessel and to the shipper's cargo. In fact, for reasons that are explained further in the section on "spoliation," it probably better serves the long term interests of the carrier to permit early access to the vessel and the physical evidence.

A practical bit of advice: owner's counsel will need a rather large and skilled team of persons to gather and photograph evidence in the early stages after the vessel's arrival. Therefore, a team should be gathered and given specific roles. In the APL CHINA loss, the vessel arrived with extraordinary wreckage from stem to stern. We had to assemble two teams of employees to work from very early each morning beginning at the bow and working aft, searching for, tagging, logging, photographing and protecting by wrapping in plastic items of evidence such as broken lashing gear, damaged appurtenances of the vessel and related items. Stevedores were standing by at great cost, so the evidence needed to be gathered carefully and quickly to enable the process of clearing debris and discharging the vessel to begin. A very skilled photographer and videographer will be an absolute necessity because the entire process will need to be documented as protection against claims of spoliation.

VI. VESSEL INSPECTION AND DEPOSITIONS *DE BENE ESSE*

While owner's counsel should have access through his client to the witnesses and the physical evidence involved in the container loss, cargo counsel must go through proper channels to develop most of his factual investigation. Most investigation occurs by agreement of the parties and cargo counsel must tread carefully if he attempts to proceed by court order rather than by agreement. Immediate discovery used to occur following a vessel arrest or an agreed stipulation in lieu of arrest. In the wake of Sky Reefer, however, the situation is more complicated because the bill of lading may provide an alternative

forum for dispute resolution that is distant from the vessel's first port of call following the catastrophe.

Federal Rule of Civil Procedure ("FRCP") 27 provides for depositions prior to the filing of a lawsuit, but the scope of the permitted inquiry is much more restricted than routine discovery in U.S. District Court. FRCP 27 is designed for preservation of testimony which will become unavailable — not as a means for firing the first salvo of discovery. See In Re: Hopson Marine Transportation, Inc., 168 F.R.D. 560 (E.D. La., 1996).

28 U.S.C. §1782 provides that a U.S. District Court may order a witness who "resides or is found" in the district to give testimony for use in a foreign proceeding. The rule is filled with options that the Judge "may" impose and the entire issue is totally discretionary with the particular Judge. The statute does, however, provide a basis for a motion to the court by a party seeking a deposition of a crewmember who is in port at the time but whose future schedule and presence in the U.S. may be questionable.

Notwithstanding the seemingly limited discovery allowed by these provisions, courts have been very sympathetic to the plight of a litigant seeking to impose depositions or other discovery when vessels are temporarily in port following a significant loss. Some examples follow.

Ferro Union Corporation v. S.S. IONIC COAST, 1968 AMC 2385, 43 F.R.D. 11 (S.D., Tex., 1967) involved a shipment of steel delivered in Houston in damaged condition.

The charterer filed suit in the nearest Federal Court; simultaneously it filed a notice of intent to take depositions on board the vessel the following day and also for production of documents and inspection of the vessel. The vessel owner's counsel objected to the depositions, arguing that the charter party provided for arbitration in New York, and pointing out that as a rule, court-sanctioned discovery is not appropriate for a case in arbitration. As the court noted from a previous case, "[a] main object of a voluntary submission to arbitration is the avoidance of formal and technical preparation of a case for the usual procedure of a judicial trial." The court noted that decisions had upheld the ban on court-ordered discovery in cases in arbitration "except, perhaps, upon a showing of an exceptional situation." The court found such an exceptional situation to exist, accepting the premise that future availability of the crewmembers could not be certain. The court announced its essential premise to be "[t]o deny discovery here could well mean that the information sought would never be available to the arbitrators or, if available, only at great expense."

Bergen Shipping Co., Ltd. v. Japan Marine Services, Ltd., 386 F.Supp. 430, 1975 AMC 490 (S.D.N.Y., 1974) shows the Judge's indulgence of a number of procedural short-cuts taken by a lawyer desperate to depose crewmembers. With the vessel and crew resting in New York for the moment, counsel for the Liberian-registered ship owner filed an *ex parte* action with the U.S. District Court for the Southern District of New York seeking leave to serve the charterer by telex in Japan and to depose the crew,

notwithstanding the charter provision calling for arbitration in Tokyo. The Judge ordered the depositions to proceed but sealed the transcripts, pending a decision by the arbitration panel how, if at all, the depositions would be utilized. The decision grapples with a number of jurisdictional issues and the rather apparent dearth of American contacts but the sympathies of the judge were revealed in his comment: "Moreover, the Court does not view with favor an attempt to achieve a result which would not only be wasteful but would also suppress evidence which, because the seamen who were deposed have since become dispersed, might, as a practical matter, never again be available."

In Koch Fuel International v. M/V SOUTH STAR, 1988 AMC 1226 (E.D., N.Y., 1987), the vessel was arrested just before it was scheduled to leave port. The following day, the vessel owner challenged the arrest, citing the contract between the parties providing for arbitration in London. The parties stipulated that the plaintiff could inspect the vessel and the defendant vessel owner agreed to provide certain documents. The parties did not agree, however, to the plaintiff's request for depositions of particular crew members. Here again, the vessel owner argued that depositions would not be available in arbitration—indeed, one of the reasons parties agree to arbitrate is to avoid expensive legal discovery. The court cited the general principle that

> [a]lthough discovery on the subject matter of a dispute to be arbitrated generally has been denied, (citations omitted), courts have recognized that discovery may be appropriate in exceptional circumstances. (citations omitted) One of the 'exceptional circumstances' in which discovery has been deemed proper is where a vessel with crew members possessing particular knowledge of the dispute is about to leave port. (citations

omitted) This court believes that the facts here meet the exceptional circumstances test.

In Deiulemar v. ALLEGRA, 2000 AMC 317 (4th Cir., 1999), the charterer filed a motion under FRCP 27 to perpetuate testimony of Greek crewmembers shortly before the vessel was scheduled to leave the shipyard following repairs. The charter agreement contained an arbitration clause in London. FRCP 27 requires 20 days notice before a deposition can be conducted. The court had no problem ignoring this limit, saying that the urgency of the situation mandates a shorter time period. The court said: "The court sees no reason why the twenty-day period set forth in Rule 27 (a)(2) is sacrosanct and cannot be modified as are many other deadlines routinely modified by the court depending on the circumstances of a particular case." The court noted that depositions are normally not available in arbitration proceedings, "[h]owever, the jurisprudence has recognized that discovery 'in aid of arbitration' is permitted by the courts where a movant can demonstrate 'extraordinary circumstances. . . .' One such example of extraordinary circumstances occurs where a vessel with crew members possessing particular knowledge of the dispute is about to leave port." The depositions were ordered to proceed and "[t]he arbitrator may then make what use of the deposition he/she deems appropriate."

Petition of Compania Chilena de Navegacion, 2004 AMC 443 (E.D., N.Y., 2004), involved a fire in the engine room which disrupted the vessel's operation and prompted a claim under the charter party. A claim was filed in Ecuador in accord with the charter agreement and the judge in Ecuador appointed a surveyor and ordered that depositions be

taken of a number of designated crew members. While this initial action was pending, the vessel left Ecuador and traveled to the United States, where she was expected to remain for less than 24 hours. The charterer filed a petition in the U.S. to preserve testimony and evidence under FRCP 27 or, in the alternative, 28 U.S.C. § 1782. Although the owner argued that the charterer was simply attempting to avoid the arbitration rules, the charterer convinced the magistrate hearing the motion that U.S. litigation was indeed possible: from the cargo interests whose shipment had been delayed for a month. Potential damage to cargo was alleged—but there were more references in the opinion to claims for delay, despite the absence of any specific reference to the type of cargo being carried or any indication why a claim for mere delay would be honored. The court allowed the depositions, noting that the crewmembers "will not only leave with the ship, but, as foreign nationals, they may never again be subject to jurisdiction here in the United States and it may be difficult if not impossible to locate them for deposition elsewhere." Whether the standard was deemed to be "extraordinary circumstances" or "special need and hardship," the court considered crewmembers whose later availability could not be guaranteed to qualify.

These decisions demonstrate that even when the ultimate forum may be a foreign arbitration, a Federal Judge often has a soft spot in her heart for good old-fashioned American depositions of the crew.

VII. EVIDENCE RETENTION

Discovery upon the vessel's arrival usually involves requests by cargo for an inspection of the vessel, retention of the gear (or remnants), photography of as much as possible, a production of the ship's documents, and depositions of the crew. The owner will be gathering at least these materials and will want to do so in as orderly a fashion as possible. In a large catastrophe the number of interests tends to expand and there are typically multiple lawyers involved representing multiple parties. It will therefore be critical to be able to keep a record of what documents have been gathered, which have been produced and to whom, and which have been withheld under a claim of privilege or otherwise. Similarly efforts to preserve and make physical evidence available for inspection and testing are critical so that the owner will be in a position, hopefully, to defend the case on the merits rather than face the dissembling of motions alleging spoliation and discovery abuses.

Evidence used at trials is customarily divided into four categories: physical, documentary, fact, and expert. All four types need to be considered at the outset of a large container loss.

Physical evidence. Failed parts may well hold the key to determining what specifically caused the loss. Parts must be identified quickly: the first thing the longshore gangs do is unlash and unload the vessel. Decks will be swept clean. If requests are not

made for preservation, the vessel's understandable attempt to return to its regular business schedule may result in the innocent but damaging disposal of items which might later become important. Coordination is crucial as is organization. A bag of fittings means nothing. They need to be numbered, logged and photographed in order to be able to establish later where they were found what role they played in the cargo securing system. Photographs and videos can be helpful but over-reliance on filmed documentation can be a hazard; a hand-written log is still needed. Items need to be assigned an evidence number that is either tied to the item on a tag or is written on using white marker. That number needs to be recorded in the log and should also be shown in any photographs or video of the item. These steps are critical if the item later becomes important through testing or other analysis. A "chain of custody" will be needed.

Documentary evidence. Although ship documents are more likely than used parts to be preserved as a standard business practice, prompt action can make a difference nonetheless. The ship's log provides a road map and the sooner the log can be reviewed, the sooner key issues can be identified. Rough logs should be requested and reviewed whenever possible. Logs also should be available for depositions of crewmembers to maximize efficiency. In addition to handwritten logs, modern vessels are equipped with many items of electronic gear that keep internal records of events in memory. Often the memory on the hard drive of, e.g., cargo stow plan and stability computers, is purged automatically with either the next use or the passage of time. Sometimes nothing can be

done – particularly where the ship and crew went through horrific weather and were out of communication. Items such as alarm loggers in the engine room that will show when certain alarms tripped will help to establish critical timelines, as will course recorders and bell books. Modern ships often control stability with computer aided systems. Their memory and retention should be considered. Computer forensics experts, though expensive, may be necessary in an appropriate case.

Fact witnesses. In order to prove a case, the first step is always to determine what happened. Proving why follows. Taking depositions of crewmembers at the initial port has the great advantage of pinning down the issues which will eventually determine the result. A more cynical person might say that doing so also provides the best opportunity to take advantage of exhausted crewmembers whose nerves are frayed by what may well have been one of the most harrowing experiences of their lives.

If crewmembers are not going to be deposed at the initial port, however, it is important to obtain some agreement when and where they will be deposed, whether it be the next city on the itinerary or the next round trip of the vessel—provided the same crew accompanies the vessel on its next voyage.

Counsel preparing such crew members for testimony needs to exercise great caution and care. These men and women are frequently of foreign nationalities and interpreters are necessary. Crewmembers are often quite nervous and there is rarely

enough time to prepare them for the experience of giving a deposition. Time must be allotted to do a careful job. Owner's counsel also needs to bear in mind that these crew members may not necessarily ever again be available to testify on behalf of the ship owner. Thus, a decision should be made regarding whether to preserve in admissible format the favorable testimony a crew member might have to offer. The authors have had the great fortune to meet and interview men who performed feats at sea that were nothing short of heroic; in some instances perhaps single-handedly saving their ship and shipmates. These people should be honored if at all possible; not excoriated in a hastily assembled adversarial deposition. Owner's counsel should safeguard such crew members.

Expert witnesses. In a major casualty, expertise will be critical. Owner's counsel will typically have an expert involved unless the cause of the loss is clear. A recent example where an expert was not considered necessary involved a loss of all containers from one hatch where the stack weights were heavier on top than on bottom, against the dictates of the stow plan. In the APL CHINA, however, a naval architect was on scene from the very beginning and was a critical part of the defense team. Other cases, involving collisions, fires and groundings will typically require an expert on scene from as early as possible. In making these decisions, it should be kept in mind that very shortly after all the cargo is discharged and the vessel cleaned up, she will go into a ship yard for at least temporary repairs and things will start to change.

Often, one or more expert witness will join the fray later, after the factual issues have been developed. For the expert to be effective, however, the proper groundwork needs to be done on the vessel. Whether the expertise is lashing, metallurgy, physics or navigation, the factual foundation on which the expert opines must be developed at the outset. The marine surveyor[17] can be a key link in this process. Even if the surveyor might not be an expert witness at trial, he can point the attorney in the right direction and he can provide the factual basis necessary as a foundation for the expert's opinions.

[17] It bears mentioning that the casualty may give rise to a need for both a cargo surveyor (to keep track of cargo and its condition as it is removed from the ship and to work with surveyors for cargo interests in re-packing and shipping cargo that might be salvageable) and a hull surveyor to deal with non-cargo matters. In a heavy weather case, the presence or absence of structural damage to the hull is likely to have a bearing on the success of the defense.

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VIII. SPOLIATION

Spoliation is the legal term for the intentional destruction of evidence by one party which prevents the other party from using said evidence as part of its case. Spoliation can result in a court imposed presumption that the destroyed evidence would have provided damaging information against the party who destroyed it. Sometimes the sanctions can be worse.

The spoliation issue can arise in any setting but admiralty cases certainly endorse the concept. In Vodusek v. Bayliner Marine Corp., 1996 AMC 330 (4th Cir., 1995), a 28 foot cabin cruiser exploded half an hour after its owner had fueled the boat "by siphoning gas from several gas cans." The owner eventually died from the burns and related complications. His widow sued the boat manufacturer and the seller who had sold the boat to the decedent when it was 10 years old. The family's expert witness and the two sons of the decedent conducted destructive testing to such an extreme that the trial court characterized the investigation by stating that they "virtually attacked the boat with a chain saw and sledge hammer. The area which is critical to the theory eventually presented by [the expert], was literally ripped apart. The integrity of the structure was violated...[the expert's] activity made it impossible for his own theory to be verified or for the Defendants to make a full and fair inspection to develop alternative theories based on the evidence." In its instructions to the jury, the trial court stated: "It is the duty of a party, a party's counsel and any expert witness, not to take action that will cause the destruction or loss of

relevant evidence where that will hinder the other side from making its own examination and investigation of all potentially relevant evidence." The judge's instruction continued with the ultimate penalty: "If you find in this case the plaintiff's counsel and agents, including [the expert] failed to fulfill this duty, then you may take this into account when considering the credibility of [the expert] and his opinions and also you are permitted to, if you feel justified in doing so, assume that evidence made unavailable to the defendants by acts of plaintiff's counsel or agents, including [the expert], would have been unfavorable to the plaintiff's theory of the case."

The standards of a spoliation argument require proof of the following elements: "(1) existence of a potential civil action; (2) a legal or contractual duty to preserve evidence; (3) destruction of that evidence; (4) significant impairment in the ability to prove the lawsuit; (5) a causal relationship between the evidence destruction and the inability to prove the lawsuit; and (6) damages." See Nance v. Crowley, 2000 AMC 2489 (Florida Circuit Court, 2000). Other courts have phrased the elements with different language, but the principles are the same. See Kronisch v. U.S., 150 F.3d 112, 126 (2d Cir., 1998) and Nation-Wide Check Corp., Inc. v. Forest Hills Distributors, Inc., 692 F.2d 214, 217-19 (1st. Cir., 1982).

These factors show that the arrival of a limping container ship creates an automatic danger of a spoliation allegation. Owner's counsel should expect a request to "preserve all evidence." Such unhelpful requests are a tip that the opposing lawyer already has a

spoliation motion prepared. And well he should. Evidence preservation is a tricky and dangerous area, particularly given the amount, size and scale of the evidence likely to be strewn about the tangled deck of a container ship that has suffered a major casualty or series of casualties. The elements of a spoliation claim are virtually all present: A potential civil action from cargo interests exists; the ship and its gear are within the exclusive control of the vessel operator; and, perhaps most importantly, the vessel operator, who is typically thinking about the business of trade rather than litigation wants nothing more than to get rid of damaged equipment, fix any vessel damage, and let the vessel be on its way to catch up on the delivery schedule which has already suffered as a result of the catastrophic loss in the first place. The operator who destroys the evidence before other interests have had a reasonable opportunity to inspect invites a spoliation argument from cargo interests.[18]

The only reported spoliation decision in a container overboard situation is American Home Assurance Co. v. M/V TABUK, 170 F.Supp.2d 431, 2002 AMC 184 (S.D.N.Y., 2001). Unfortunately the case does not address the specific facts sufficiently to give more than the inkling that the theory is plausible. The case involved the shipment of missiles to the Kuwait National Guard, traveling on a vessel from Wilmington, North

[18] The operational pressure to get the vessel cleaned up, repaired and back in service cannot be underestimated. "Legal" must stand its ground on both preserving evidence and doing it right. Of course, "legal" must also deliver its services at earlier and longer than usual hours, with great alacrity and imagination.

Carolina across the Atlantic. For a single 20 foot container, the loss paid by cargo underwriters was $2,560,250.00! The carrier made a shrewd defense maneuver at the outset: it admitted liability and fought the case based on the per package limitation. Two package limitations were possible: $4,500 for each of nine pallets of missiles or $50,000 for each of 100 boxes of missiles which comprised the pallets. Cargo counsel argued a variety of reasons the package limitation should not apply, but ultimately the only solace was that the package limitation was applied to each box rather than each pallet—thereby securing a 2% gross recovery on the case. Among the arguments that were made in the futile attempt to avoid the package limitation was deviation: the allegation was that under the circumstances, the carrier acted unreasonably by stowing the container on deck. The spoliation argument gives only a hint of what might actually have happened. The court stated that "American Home argues that [the carrier] willfully and intentionally disposed of the failed lashings; that its expert therefore was unable to inspect the lashings; that [the carrier] willfully and intentionally removed, destroyed and failed to produce certain lashing gear equipment reports and summaries; and that such failure to preserve crucial evidence after the loss of the Cargo constitutes spoliation of evidence for which damages are appropriate." If the court had been faced with a decision on liability, such arguments might have been meritorious. Since liability had been admitted, however, the court concluded that the spoliation argument had no bearing on the deviation issue.

IX. REPORTED CONTAINER LOSS CASES OF NOTE

The reported cases involving container losses typically focus on shifting burdens of proof, efforts of the carrier to show due diligence to render the vessel seaworthy, and — most of all — the peril of the sea defense in general and heavy weather in particular. As everyone is aware, most container losses occur during storms; a key issue is the extent to which the carrier must anticipate and plan for the storms which occur.

Access to the vessel immediately after the loss is a critical issue in container overboard cases. Anyone who thinks dealing with American port officials and longshoremen might be difficult should review Royal Embassy of Saudi Arabia v. S.S. IOANNIS MARTINOS, 1986 AMC 769 (E.D.N.C., 1984) which involved the loss of 87 containers on a voyage from Wilmington, North Carolina to Damman, Saudi Arabia. After the vessel's arrival December 12, the vessel was detained by officials of the Saudi Arabian government for over 2 months, until February 19. Interestingly enough, a number of the lost containers were owned by the government of Saudi Arabia itself. As with many container loss cases, the key issue was the manner in which the load was lashed and secured; unlike many other container cases, however, the loading, stowing, and securing of the containers was not the exclusive domain of the vessel and its stevedores because the National Cargo Bureau and other cargo consultants had been retained by the parties to supervise. The court's framing of the issues is interesting: "While the weather encountered by the S/S IOANNIS MARTINOS during this ill-fated voyage is somewhat in dispute,

there was no weather encountered which should not have been anticipated. In and of itself, this gives rise to questions of sufficient loading and stowage."

Houlden & Co., Ltd. V. S.S. RED JACKET, 1977 AMC 1382 (S.D.N.Y., 1977) is one of the earliest trial decisions in a container overboard case and it is also one of the most comprehensive in reviewing the facts of the container stowage and securing. The case involved the loss of 43 containers overboard following a collapse of one container, which disrupted the stow. The carrier alleged that a particular container of tin ingots had been improperly secured; the court agreed that the ingots had been improperly secured within the container but denied the claim that this improper securing was proximately related to the collapse. Instead, the judge found the container itself to be deficient—and the carrier had supplied the container. The weather, which reached 50-55 mile per hour winds (Force 10) and caused the vessel to roll up to 35 to 40 degrees to port, was admitted by the carrier to be "the type of weather to be expected in the month of January in the North Pacific."

Marsh, Inc. v. S.S. JOHANN BLUMENTHAL, 455 F. Supp. 236, 1979 AMC 240 (S.D.N.Y., 1978) reached an opposite result, accepting the vessel's contention of the "big wave" which caused the containers to collapse. In a crossing of the Atlantic, the vessel encountered a storm with winds of force 9 to 10 but also waves ten meters high. Notwithstanding testimony that the placement of the particular container, which was

aluminum rather than steel, in a particularly exposed position, deemed to be a "dangerous place," the court upheld the vessel's peril of the sea defense, finding that a steel container in the same position would have also been severely damaged.

Taisho Marine v. MV SEA-LAND ENDURANCE, 815 F.2d 1270, 1987 AMC 1730 (9th Cir., 1987) is most noteworthy for its attempt to offer some guideposts with respect to the heavy weather defense. The Court of Appeals affirmed the District Court decision which upheld a heavy weather defense. The factual findings were specific: "the vessel ENDURANCE encountered at least four waves in excess of 60 feet which rolled the vessel more than 40 degrees. A substantial number of waves between 40 and 60 feet in height battered the vessel. During the storm...the sustained winds remained between Beaufort Force 10 (48-55 knots) and 12 (64-71 knots) with gusts in excess of 95 knots.... The court found that only a few vessels in the area between 1946 and 1984 reported seas of equal or greater height and that the sustained winds of 65 knots were the highest ever recorded in the area." The court also noted structural damage to the vessel. In summing up the heavy weather cases, the court provided the oft-quoted measuring stick: "...courts have almost always found a peril of the sea where the force has been 11 or grater and very few cases are found to qualify where the winds are force 9 or less. Wind velocity, however, is only a rough measure and must be considered with other indicia such as nature and extent of damage to the ship, cross-seas and other factors."

X. CONCLUSION

Significant loss of containers at sea always leads to major litigation. Unlike typical civil litigation, the circumstances result in most of the trial investigation and preservation of testimony occurring within the first few days, and usually no more than weeks, of the casualty. Much of this initial factual investigation can never be repeated. Despite the best good faith efforts to preserve evidence, when the ship sails something of significance could sail with her. While surveyors and experts can recheck some particular facet on a succeeding voyage, it is extraordinarily difficult to begin an investigation of any particular area a month after the fact, after the conditions have changed. Owner's counsel must anticipate where litigation will lead and plan accordingly, keeping in mind the many and varied interests and potential pitfalls that are present in the initial phases of a large and complex casualty. For cargo counsel, if investigation is not conducted at the first port, the chance of a successful recovery plummets.

No area of maritime law provides a more concentrated dose of hectic activity than meeting a ship after a serious casualty with loss of multiple containers. The dual roles of owner's and cargo counsel cannot be filled by the same lawyer or firm; but those occupying the position carry fundamentally the same duties in the initial stages of casualty investigation. Regardless of what position you occupy, we cannot over-emphasize our central message: Do not waste the golden opportunity of an early investigation.

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TRIGGERS – A SURVEY OF RECENT TEXAS LAW ON FIRST-PARTY AND THIRD-PARTY PROPERTY DAMAGE CLAIMS AND THE APPORTIONMENT OF COVERAGE

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Triggers—A Survey of Recent Texas Law on First-Party and Third-Party Property Damage Claims and the Apportionment of Coverage

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I. INTRODUCTION

When does "bodily injury" and/or "property damage" occur under a liability policy? Does it make a difference if the policy is a first-party property policy? If multiple policies are triggered, how is coverage apportioned? These basic coverage issues are common to all types of policies and all lines of coverage. Further, the issues of trigger and coverage are continually the subject of litigation in Texas. For example, years of litigation transpired in this state over which carrier was responsible for the allegations of bodily injury and property damage brought by residents living in and around refinery row in Corpus Christi, Texas. Similarly, as discussed below, the Fifth Circuit has had to consider which carrier was responsible for property damage to cargo found to be defective while at sea. This paper will address the issues of trigger and allocation under Texas law and will provide a survey of how courts have addressed these issues.

II. ISSUES COMMON TO ALL POLICIES: WHEN IS COVERAGE TRIGGERED?

All policies generally specify their respective inception and expiration dates. As such, in the majority of cases, the determination of which policy applies to a loss is relatively simple--a policyholder applies the policy whose date corresponds to the loss. In cases in which a latent-type injury or damage occurs the determination of which policy applies becomes more complicated and may require the application of a particular "trigger" theory. The trigger theory applied will be important because depending on what event must occur in order to trigger coverage under a policy, an insurer may not be obligated to provide coverage at all. In the past few years, this issue has been frequently addressed by Texas courts in all lines of coverage. Unfortunately, the new opinions have only clouded the issue and there no longer appears to be a consensus in Texas as to the appropriate trigger.

Although all Texas courts recognize coverage is not triggered until actual injury or damage occurs, they have greatly differing views as to how the date of injury or damage is determined. *See American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 853 n.20 (Tex. 1994). In determining the date of injury or damage, Texas courts have identified four separate explanations of when injury or damage may "occur" and thus "trigger" coverage under a policy. These theories include:

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(1) the "exposure theory," arguing that all policies in effect during the date of physical exposure to the injurious substance provide coverage;

(2) the "manifestation theory," holding that the policy in effect when the injury or damage was discovered or reasonably could have been discovered owes coverage;

(3) the "continuous trigger theory," holding that all policies from the date of first exposure to the injurious substance through manifestation of injury or damage are responsible for coverage; and

(4) the "actual injury theory," holding the policy in effect when the injury actually occurred, even if not discovered at that time, owes coverage.

Id.

A. 1986-1999 MANIFESTATION THEORY ADOPTED FOR THIRD-PARTY PROPERTY DAMAGE CASES

From 1987 until 1999, both the Fifth Circuit and Texas state courts universally adopted a "manifestation of damages" standard for determining the date of coverage in cases involving property damage. While the Texas Supreme Court has not yet addressed the "trigger issue," two "manifestation" decisions from the Houston and Dallas Courts of Appeals were authored by two current Justices of the Texas Supreme Court. *Dorchester Dev. Corp. v. Safeco Ins. Co.*, 737 S.W.2d 380 (Tex. App—Dallas 1987, no writ) (Enoch); *Coastal Refining & Mktg., Inc. v. Coastal Offshore Ins. Ltd.*, 1996 WL 87205 (Tex. App—Houston [14th Dist.] Feb. 29, 1996, no writ) (O'Neill). There are even two opinions regarding property damage directly on point from the Fifth Circuit Court of Appeals. *See American Home Assur. Co. v. Unitramp, Ltd.*, 146 F.3d 311 (5th Cir. 1998); *Snug Harbor Ltd. v. Zurich Ins. Co.*, 968 F.2d 538 (5th Cir. 1992).

In *Snug Harbor Ltd. v. Zurich Insurance Co.*, the Fifth Circuit explained: "Texas courts have concluded that the time of an occurrence is when a claimant sustains actual damage—not necessarily when the act or omission causing that damage is committed." *Id.* at 544. In reaching this holding the Fifth Circuit relied on *Dorchester Development v. Safeco Insurance Co.*, 737 S.W.2d at 380, in which the Dallas Court of Appeals also adopted a "manifestation theory" when analyzing property damage claims under a liability policy. In *Dorchester*, the court specifically looked to the policy language defining the term "occurrence" and held:

> [I]t is well settled that the time of the occurrence of an "accident," within the meaning of a liability indemnity policy, is not the ***time the wrongful act was committed but the time the complaining party was actually damaged.***

Id. at 383 (emphasis added).

Relying on the definition of "occurrence," the court went on to explain: "no liability exists on the part of the insurer unless the . . . damage manifests itself, or becomes apparent, during the policy period." Because the insured in *Dorchester* had admitted through requests for admissions that the property damage in question did not manifest during the policy period in question, the court concluded that there was no "occurrence" during the policy period. *Id.* at 384.

In recent years, courts have had to consider how to apply the "manifestation" theory in a number of circumstances. In *American Home Assurance Co. v. Unitramp, Ltd.*, the insured, Enjet, was a fuel broker which contracted to provide fuel for overseas shipping. Two days out to sea, the purchaser of the fuel, Unitramp, tested its load and determined the fuel contained excessive water. Unitramp then sued Enjet for its losses resulting from the contamination. Enjet's insurer argued there was no manifestation in its policy period (which began when the ship was at sea) because Unitramp could have discovered the watered nature of the fuel within three and one-half to four hours of loading by hiring a local laboratory to test the fuel. The Fifth Circuit rejected the "testing" argument and noted:

> It follows that Unitramp's damage was not apparent at the time the fuel was loaded. The watered nature of the fuel was not visible to the naked eye, but required offsite testing to uncover. While we respect the district court's factual finding that, by ordering an immediate test, Unitramp could have discovered the problem more promptly at "minimal effort and cost," we do not agree that the effort and cost were so minimal as to render the defect apparent or manifest.

Id. at 314. The Fifth Circuit, however, did not foreclose the possibility testing could be insignificant and noted:

> While there may be instances in which a test or inspection imposes such an insignificant burden on an insured that the defect, though hidden, can be characterized as apparent, this is not such a case.

Id.; see McKinney Builders II, Ltd. v. Nationwide Mut. Ins. Co., 1999 WL 608851 (N.D. Tex. Aug. 11, 1999) (holding erroneous property surveys were "capable of being easily perceived, recognized and understood" at time homeowners purchased their homes, not at time of discovery of error); *Aetna Cas. & Sty. Co. v. Naran*, 1999 WL 59782 (Tex. App—Dallas, Feb. 10, 1999); *Travelers Indemnity Co. v. Page*, 1998 WL 790957 (Tex. App.—Amarillo, Oct. 15, 1998) (holding trial court erred in finding coverage for insured because damage to stucco walls did not "manifest" until expiration of Aetna's policy period); *Cullen/Frost Bank of Dallas v. Commonwealth Lloyds Ins. Co.*, 852 S.W.2d 252 (Tex. App—Dallas 1993), *writ den'd per curiam*, 889 S.W.2d 266 (Tex. 1994); *Epina Properties, LTD. v. Zurich Am. Ins. Co.*, 1998 WL 223727 (N.D. Tex., Apr. 24, 1998); *Carpenter Plastering Co. v. Puritan Ins. Co.*, 1988 WL 156829 (N.D. Tex., Aug. 23, 1988); *AAF-McQuay, Inc. f/k/a SnyderGeneral Corp. v. Northbrook Prop. & Cas. Ins. Co.*, CA No. 5:96CV158 (E.D. Tex., Jan. 19, 1999)[2] (all adopting the "manifestation" trigger).

Critics of the manifestation trigger suggest the theory is not justified by a plain reading of the definition of "occurrence" in the standard CGL policy. The argument essentially takes issue with the interpretation of the occurrence definition as requiring the damage to *actually become apparent* during the policy period. Rather, such courts contend the policy merely requires the

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[2] *AAF-McQuay* dealt with an action to recover the costs of cleaning up environmental contamination around the insured's facility. United States District Judge David Folsom applied the "manifestation" trigger and held U.S. Fire owed no coverage because the environmental damage did not become apparent during its policy period.

injury, loss, damage, or destruction to happen during the policy period—irrespective of the time of discovery. Prior to 2000, at least one Texas court applied a "continuous" trigger to property damage claims. *See Dayton Indep. School Dist. v. National Gypsum Co.,* 682 F. Supp. 1403 (E.D. Tex. 1988), *rev'd on jurisdictional grounds sub nom.; W.R. Grace & Co. v. Continental Cas. Co.*, 896 F.2d 865 (5th Cir. 1990). In *National Gypsum Co.*, the United States District Court for the Eastern District of Texas held property was damaged from the installation of asbestos until the products were removed and contained. All policies on the risk during this time period were therefore triggered.

B. 2000: EXPOSURE THEORY ADOPTED FOR THIRD-PARTY BODILY INJURY CLAIMS

All courts (including Texas courts) have had greater problems in determining the appropriate trigger for latent bodily injury claims where neither the insured nor the claimants are immediately aware of the injury-causing event and the injury does not manifest until several decades after the initial exposure (*i.e.* asbestos claims). While purporting to apply the same body of law which has provided adequate guidance in the past, most courts have reacted to the alleged seriousness of the bodily injuries by shading their interpretation of prior precedent and the CGL policy language with public policy arguments that bodily injury and property damage claims are somehow different in application. Prior to 2000, there was no real guidance on this issue from Texas courts. While the Fifth Circuit had adopted an "exposure" trigger each time it had addressed a claim for latent bodily injuries under ***Louisiana*** law, (*see Porter v. American Optical Corp.*, 641 F.2d 1128 (5th Cir. 1981)[3]) it was unclear whether this body of law would apply to "bodily injury" claims in Texas.

In March of 1998, a federal court in Houston addressed the issue of when an asbestos-related injury "occurs" for the first time under Texas law. In *Guaranty National Insurance Co. v. Azrock Industries Inc.*, No. H-97-64, (S.D. Tex., Mealey's Document #03-980407-104), the U.S. District Court for the Southern District of Texas noted a general liability policy addresses the occurrence of a resulting injury, not the occurrence of a risk which has not manifested itself as an injury. Judge Lynn Hughes explained:

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[3] *Porter* was a products liability action brought against a manufacturer of respirator and filter apparatus for damages resulting from asbestosis contracted while the plaintiff was a factory employee and while he was supposed to have had the protection of the respirator and filter apparatus. The three insurance companies that insured the manufacturer at different times were also joined in the lawsuit. At trial, the jury found the respirator to have been defective and the sole cause of the plaintiff's death. Thereafter, the United States District Court for the Eastern District of Louisiana rendered judgment against the insurance company that had insured the manufacturer when the asbestosis first manifested itself in the plaintiff. The District Court reasoned that the policy definition of "bodily injury" could be equated with "sickness and disease." Therefore since a sickness or disease did not manifest itself during two of the insurer's policies, the court found no coverage under those other policies. On appeal, the Fifth Circuit did not engage in any policy language analysis, but instead, made an *Erie* determination that Louisiana would adopt the exposure theory. *Id.* at 1145. The court apparently believed the application of the theory was an equitable method of increasing coverage to the injured worker because it spread liability and costs proportionately among all insurers which insured the manufacturer of the defective product. *Id.*; *see also Ducre v. Executive Officers of Harlter Marine, Inc.*, 752 F.2d 976 (5th Cir. 1985); *Cole v. Celotex Corp.*, 599 So.2d 1058 (La. 1992) (adopting "exposure" theory under *Porter*).

> [t]he clear policy language requires an occurrence during the policy period before there can be coverage. An occurrence under the policy is not present unless continuous or repeated exposure actually results in personal injury. Texas courts and federal courts applying Texas law have determined that coverage is triggered when an injury manifests itself, and only those insurance policies in effect at that time provide coverage.

Thus, with respect to both the asbestos bodily injury lawsuits and the asbestos property damage lawsuits brought against Azrock, Judge Hughes applied the "manifestation" trigger universally.

On March 10, 2000, the Fifth Circuit reversed the district court in a published opinion styled *Guaranty National Insurance Co. v. Azrock Industries, Inc.*, 211 F.3d 239, 251-52 (5th Cir. 2000). While the Fifth Circuit agreed with the District Court's construction of the policy to the extent it determined that an occurrence during the policy period requires that actual injury, not just the negligent act or omission that causes the injury, must occur during the policy period, the Fifth Circuit noted:

> Where we part ways with that court is in defining the relevant "injury." The district court defined "injury" as the date an asbestos-related condition or disease manifests or becomes identifiable. In granting summary judgment, the court looked to the date of diagnosis alleged in the underlying complaints and equated "manifestation" with that date. As the court found no complaints that contained allegations of a date of diagnosis within the one-year policy period, it held that the duty to defend was not triggered in any of the suits. By contrast, we define "injury" as the subclinical tissue damage that occurs on inhalation of asbestos fibers. In remanding this case, we instruct the district court to examine each underlying complaint for allegations of exposure during the policy period, approximated by alleged dates of employment involving work with Azrock's products, to determine whether the duty to defend is triggered.

Id. at 244. In adopting the "exposure" rule, the Fifth Circuit rejected Azrock's argument that it should adopt the continuous trigger and, instead, noted that Guaranty National had correctly briefed that the Fifth Circuit had twice adopted the exposure theory in attempting to predict Louisiana law. *Id.* at 249-250. In adopting its prior analysis under Louisiana law, the Fifth Circuit held that for duty to defend purposes:

> [T]he district court on remand need only examine the face of the underlying complaints in light of our holding today regarding interpretation of the CGL policy language. To trigger Guaranty National's duty to defend, the pleading must allege (1) exposure to Azrock's asbestos-containing products during the policy period and (2) that such exposure caused bodily injury—even if the particular asbestos-related disease was not diagnosed until sometime after the policy expired. The decision we announce today is premised on our general understanding of the progressive nature of asbestos-related diseases; indeed, the genesis of the instant dispute and the plethora of asbestos-related insurance cases . . . is the proper construction of insurance policy provisions that were not drafted with that unique disease process in mind. To the extent that the parties challenge

> that general premise on the basis of the particular type of asbestos product or fiber involved, its effect on an individual plaintiff, or other grounds, those factual disputes are relevant not to the duty to defend--determined under the eight-corners doctrine--but perhaps to the duty to indemnify or as a causation defense to the underlying liability lawsuits.

Id. at 251. As to the lone property damage lawsuit against Azrock alleging damage to a building caused by asbestos, the Fifth Circuit found Judge Hughes had correctly applied the manifestation trigger. *Id.* at 252. This clarification is significant and would appear to limit a policyholder's attempt to argue that the "exposure" trigger should be applied to all types of damage and/or bodily injuries.

A close reading of the *Azrock* opinion shows that the court carefully limited its holding to the particular "asbestos bodily injuries." In fact, the first version of the opinion remanded the action for "the parties to develop medical evidence that some bodily injury, such as subclinical lung tissue damage, occurs at the time of inhalation of the particular type of encapsulated asbestos fibers that were contained in the Azrock floor tiles." *Id.* at 253. Because this would have violated the eight-corners doctrine for defense purposes, the requirement was removed from the opinion following rehearing. This hesitancy makes it is unclear if the Fifth Circuit would expand *Azrock* and adopt an "exposure" theory for all types of "bodily injury."

C. 2000: Houston Court of Appeals Revisits Trigger for Third-Party Property Damage Cases

The careful attempt by the Fifth Circuit to limit its holding to asbestos bodily injury claims did not stop Texas appellate courts from seizing on the opportunity to apply the newly crafted "exposure" rule in other contexts. Following the decision in *Azrock*, the Houston Court of Appeals considered the "trigger" issue in *Pilgrim Enterprises, Inc. v. Maryland Casualty Co.*, 24 S.W.3d 488, 490 (Tex. App.—Houston [1st Dist.] 2000, no pet. h.). In that case, Pilgrim Enterprises, Inc. was sued in seven suits by former landlords and adjacent property owners for contamination to their property and related personal injuries allegedly caused by long-term exposure to perchloroethylene (perc). The underlying plaintiffs alleged exposure from the time each facility began operations. Pilgrim requested coverage from Maryland Casualty, the insurer which issued policies to Pilgrim between December 1981 and December 1985. Granting partial summary judgment, a trial court held that Maryland Casualty had no duty to defend in five of the pending lawsuits.

On appeal, the Houston Court of Appeals noted that the case law governing when harm occurs under CGL policies is "far from settled." *Id.* at 496. In weighing the alternatives, the Houston Court of Appeals explained that Maryland Casualty argued for application of a "pure" manifestation rule, while Pilgrim argued that an injury "occurs" under the policy when damage is actually sustained through exposure, not when it is later discovered. *Id.* at 497. The Houston Court ultimately agreed with Pilgrim's position and explained that the language of the Maryland Casualty policies was occurrence-based and contemplates comprehensive, and more expensive coverage, and that the Court would have to retroactively reduce the value of the policies if it read a "claims [made]-based" requirement into it requiring that injury actually be discovered within the policy period. *Id.* at 497. The Houston Court of Appeals also agreed with the decision in

Azrock that, for CGL policies covering continuous exposure to conditions, injury can occur as the exposure takes place. *Id.* at 497-98. The Houston Court of Appeals, however, did not agree that *Azrock* should be limited to asbestos bodily injury claims and, thus, expanded the *Azrock* rationale to apply to property damage cases as well. The Court stated:

> We do not find it necessary to limit the exposure rule to physical injury, however. *Azrock* was constrained to follow Fifth Circuit precedent on property damage; we are faced with an issue of first impression. We find the Maryland policies' language, which defines an occurrence as harm caused by continuous or repeated exposure, transforms allegations of both physical injury and property damage caused by exposure to PCE during the policy periods into covered events.

Id. The Houston Court of Appeals further opined:

> We find that the policies cover physical injury or property damage caused by exposure occurring during the policy periods, even if the contamination began before the policy periods. All five of the lawsuits allege continuous exposure to contaminants released by Pilgrim that seeped or leaked into the surrounding property. Potentially, at least, all of the pleadings allege property damage occurring during the policy period because of the ongoing contamination or seepage.

Id.

D. 2003: MANIFESTATION ADOPTED AGAIN FOR THIRD-PARTY MOLD CLAIM

The issue of trigger was most recently discussed in *Allstate Insurance Co. v. Hicks*, 134 S.W.3d 304 (Tex. App.—Amarillo 2003, rehearing overruled). In that case, a homeowners' insurer, Allstate Texas Lloyds, brought a declaratory judgment action against its insured, Alvin Hicks, the seller of a house, to determine whether it owed a duty to defend or indemnify Hicks against the mold-related claims of the buyers, Michael and Lynnette Dudding. Allstate provided homeowners insurance to Hicks from December 9, 1996 (the day before the closing of Hicks' sale of the residence to the Duddings) through March 4, 1997.

In the Duddings' third amended petition, filed in March 2000, they for the first time added claims for property damage and personal injury resulting from exposure to mold which they alleged had happened in the house as a result of defects in the plumbing. The Duddings' petition further alleged the mold was discovered on February 15, 2000 and that the Duddings had occupied the residence since December 1996, *"totally unaware" of the mold contamination*, but their exposure to mold in the residence caused them personal injuries including headaches, respiratory distress and neurological impairment. Hicks soon thereafter tendered defense of the claims to Allstate under the liability coverage in his homeowners policy. Allstate denied that the policy covered the Duddings' claim and in July 2000 filed a declaratory judgment action.

The district court granted summary judgment to Hicks, and Allstate appealed. The Amarillo Court of Appeals reversed the summary judgment and held that there was no duty to defend because the Duddings failed to allege that bodily injury or property damage took place during the policy period.

In an effort to establish bodily injury or property damage during the policy period, Hicks urged the court to apply the "exposure" trigger rule embraced by the court in *Pilgrim Enterprises, Inc. v. Maryland Casualty Co.*, 24 S.W.3d at 496. Hicks also argued, under the allegations in the petition, the Duddings could have been exposed to mold during the policy period.

Though it was alleged in the petition that Mr. Dudding was in the wet basement on the day before closing of the house purchase, and that mold contamination was discovered more than three years later, there was no allegation that mold was present on the day before the closing or at the time of sale (when Allstate's policy was effective). Consequently, there was no bodily injury or property damage alleged during the policy period and, therefore, no duty to defend or indemnify existed. *See also, Mathews Heating & Air Conditioning LLC v. Liberty Mut. Fire Ins. Co.*, 2004 WL 2451923 (N.D. Tex. Oct. 21, 2004).

The holdings in *Azrock, Pilgrim,* and Hicks appear to reopen what had been a quieted debate on the proper trigger of coverage under Texas law. Hopefully, the new opinions will provide the proper platform for the Texas Supreme Court to finally resolve the question of the proper "trigger" for both bodily injury and property damage claims in Texas. Until such time, these opinions may have far-reaching implications and allow policyholders to trigger coverage under policies which expired many years ago.

E. Practical Considerations

Obviously, in an indemnity situation the question of when property damage manifested or when the underlying plaintiffs were exposed to chemicals are fact issues which can be resolved through medical records, maintenance records, examinations under oath, etc. The more difficult question is how to handle the duty to defend when the petition does not allege facts to determine manifestation and/or exposure.

Traditionally, Texas follows the "Eight Corners" rule when determining an insured's duty to defend. Under this approach, the allegations of the complaint should be considered "without reference to the truth or falsity of such allegations and without reference to what the parties know or believe the truth as to be, [and] without reference to a legal determination thereof." *Heyden Newport Chem. Corp. v. Southern Gen. Ins. Co.*, 387 S.W.2d 22, 24 (Tex. 1965). In other words, in reviewing the underlying petition, Texas courts focus on the factual allegations showing the origin of damages rather than on the legal theories alleged. The underlying factual allegations are liberally construed, and any doubt as to whether the allegations fall within the coverage of the policy is resolved in the insured's favor. *Id.* If the underlying petition does not allege facts within the coverage of the policy, however, the insurer is not required to defend the suit against its insured. *Id.*

In such a situation where the petition does not contain sufficient facts to make a trigger of coverage determination, courts are admonished not "read facts into the pleadings" or "imagine factual scenarios which might trigger coverage." *Guaranty Nat'l Ins. Co. v. Azrock Indus., Inc.*, 211 F.3d 239, 251-52 (5th Cir. 2000) (citing *St. Paul Ins. Co. v. Texas Dep't. of Transp.*, 999 S.W.2d 881, 884 (Tex. App.—Austin 1999, pet. denied)). For example, when applying the

"exposure" trigger the in *Azrock, supra.,* the Fifth Circuit left the trial court some parting instructions on how to review the underlying petitions:

> Our cursory review of the pleadings included in the record on appeal suggests that some of the complaints clearly allege relevant employment in asbestos tile installation or related work during the policy period as well as causation; those complaints would trigger the duty to defend. Others clearly allege employment (ergo exposure) that ended prior to the policy period; Guaranty National would have no duty to defend those complaints. And still others do not allege a period of exposure or relevant employment at all. Again, Texas law instructs us that in applying the eight-corners rule, a court must resolve doubts in favor of the insured but may not read facts into the pleadings, may not look outside the pleadings, and may not merely imagine fact patterns that might trigger coverage. Therefore, for complaints lacking an allegation of exposure, the district court on remand should not impose a duty to defend on Guaranty National.

Id. at 251.[4]

F. ALLOCATION

Where a continuous occurrence, such as the one at issue, results in injury which triggers coverage under more than one policy period, an appropriate method for allocating the losses, deductibles, etc. among the multiple policies must be devised. Texas courts have devised at least two methods to allocate these type of costs. The methods include: (1) joint and several liability (or vertical exhaustion) and (2) pro-rata (or horizontal exhaustion).[5]

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[4] It is also worth keeping in mind that a minority position exists in Texas with respect to the "Eight Corner" doctrine. Several Texas cases, and a number of federal cases interpreting Texas law, have allowed the introduction of extrinsic evidence to resolve factual questions not plead in the underlying lawsuit. *See e.g., Cook v. Ohio Cas. Co.,* 418 S.W.2d 712, 714 (Tex. Civ. App.—Texarkana 1967, no writ); *State Farm and Casualty Company v. Wade*, 827 S.W.2d 448, 453 (Tex. App.—Corpus Christi 1992, writ denied); *Western Heritage Ins. Co. v. River Entm't*, 998 F.2d 311 (5th Cir. 1993) (extrinsic evidence considered to determine if liquor liability exclusion excluded coverage when petition made no reference to alcohol or intoxication). When faced with an underlying petition which contains vague or insufficient factual recitations, however, it is important to remember that the extrinsic evidence exception may provide a means to create or exclude coverage.

[5] Please note, these issues only arise when the court applies an "exposure," "injury-in-fact," or "continuous trigger" theory of coverage which tend to implicate multiple policies over an extended period of time. By contrast, however, allocation is not an issue under the "manifestation" trigger which assigns all loss to the policy in existence when the bodily injury/property damage manifests.

1. Pro-Rata Allocation

Under a pro-rata approach, the court prorates the defense and/or deductible the insured must pay based on the time each triggered policy was on the risk in relation to the total period during which the damage/injury took place. For example, if an insured had three carriers over a ten year period, the insured would be responsible for the deductible, defense costs, etc. based on the number of years of its coverage with the carrier in relation to the total years over which the risk is spread. Thus, if insurer A insured the policyholder for two years with a $25,000 deductible, insurer B provided coverage for three years with a $100,000 deductible and insurer C provided coverage for five years with a $250,000 deductible, the insured would owe 2/10 of the $25,000 deductible or $5,000, 3/10 of the $100,000 deductible or $30,000, and 5/10 of the $250,000 deductible or $125,000.

The definitive opinion regarding the issue of apportionment of defense and indemnity cost comes out of the Sixth Circuit. In *Insurance Co. of North America v. Forty-Eight Insulators*, Inc., 633 F.2d 1221, 1224-5 (6th Cir. 1979); clarified, 657 F.2d 814, 816 (6th Cir. 1981), *cert. denied*, 454 U.S. 1109 (1981), a declaratory action was brought to determine an insurance carrier's duty to defend or indemnify a manufacturer of asbestos products. The court adopted the exposure theory and prorated defense obligations among all the insurance companies which were on the risk while the injured party was breathing in asbestos. The court refused to impute to the insurers the insured's joint and several liability under tort law. The court noted that "in allocating the cost of indemnification under the exposure theory, only contract law is invited. Each insurer is liable for its pro rata share. The insurer's liability is not 'joint and several,' it is individual and proportionate." *Id.* at 1225.

An additional issue presented was whether the insurer had to pay for the entire cost of defense even though the manufacturer was uninsured during a portion of the time the individuals bringing suit alleged they were exposed to the asbestos products. In holding the insured would be required to share in a pro rata apportionment of the defense costs, the court stated:

> An insurer must bear the entire cost of defense "when there is no reasonable means of prorating the cost of defense between the covered and non-covered items." Thus, in a typical situation, suit will be brought as the result of a single accident, but only some of the damages sought will be covered under the insurance policy. In such cases, apportioning defense costs between the insured claim and the uninsured claim is very difficult. As a result, courts impose the full cost of defense on the insurer.
>
> These considerations do not apply where defense costs can be readily apportioned. The duty to defend arises solely under contract. An insurer contracts to pay the entire cost of defending a claim which has arisen within the policy period. The insurer has not contracted to pay defense costs for occurrences which took place outside the policy period. Where the distinction can be readily made, the insured must pay its fair share for the defense of the non-covered risk.

Id. at 1224-25 (citations omitted).

While noting the different insurance companies would prorate defense costs among themselves, the court further determined it was reasonable to treat the insured as an insurer for those periods of time in which it had no insurance coverage. *Id.* at 1225. As an analogy, the court provided an example in which a manufacturer exposed individuals to asbestos for a period of twenty years, while only having insurance coverage for one year. The court opined that to hold the insured would be entitled to a complete defense for the entire twenty year period would be illogical. *Id.* As a result the manufacturer in this case was required to share in the cost of its defense.

The Fifth Circuit applied the same reasoning in deciding *Gulf Chemical and Metallurgical Corp. v. Associated Metals and Minerals Corp.*, 1 F.3rd 365 (5th Cir. 1993). In *Gulf Chemical*, a chemical manufacturer sued its CGL insurers seeking a declaratory judgment, alleging the defendants breached their contractual duties to defend it in a toxic-tort case. Much like the *Forty-Eight Insulators* case, there was a period of time in which individuals were exposed to toxic substances while the manufacturer did not have insurance coverage. In holding that the logic of *Forty-Eight Insulators* and *American Optical*[6] regarding pro rata apportionment would apply in Texas, the court commented:

> By our holding, we simply recognize that, in latent injury toxic-exposure cases like this one, insurers need not provide separate defenses, but may be compelled by the insured to share in the cost providing a complete defense. It follows that the insured must bear its share of the cost determined by the fraction of time injurious exposure in which it lacked coverage.

Id. at 372. In so holding, the court specifically rejected the idea that the court should impose the full cost of defense on one insurer and noted that "where costs can be readily apportioned, as here, it is reasonable to have [the insured] pay its fair share of defense costs." *Id.* at 371. Consequentially, the insured Gulf Chemical was required to help provide in the cost of its defense due to the years of exposure in which it did not have any insurance coverage.

The same rationale has been applied to deductibles. The threshold Texas opinion regarding the issue of apportionment of deductibles comes out of the Fifth Circuit Court of Appeals in *Lafarge Corp. v. Hartford Casualty Insurance Co.*, 61 F.3d 389 (5th Cir. 1995). In that case, the Court construed Lafarge's obligations to pay its deductibles under multiple policies. The insurers argued Lafarge was responsible for the total amount of each deductible based on the clear policy language. The District Court disagreed and concluded that, although the policy language was unambiguous, fairness mandated an apportionment of the deductibles. The Court stated:

> [I]t would be patently unfair to expect Lafarge to satisfy the entire amount of every deductible in every insurance policy. If that were the case, Lafarge would recover very little, if any, of its defense costs. That is not the result the Court intended when it decided to reduce Hartford's portion of the total defense costs.

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[6] 641 F.2d 1128 (5th Cir.), *cert. denied*, 454 U.S. 1109 (1981).

Lafarge Corp. v. Hartford Cas. Ins. Co., No. H-91-0940, slip op. at 3 (S.D. Tex. Dec. 7, 1991), *aff'd in part, rev'd in part on other grounds*, 61 F.3d 389 (5th Cir. 1995). Moreover, the District Court concluded payment of a full deductible under a policy which is responsible for only a portion of the defense costs "does not seem to coincide with either the spirit behind the insurance contract between the parties, or this Court's previous Order which attempted to apportion the defense as equitably as possible." *Id.* at 401, quoting slip op. at 8.

The Fifth Circuit affirmed the lower court's apportionment of deductibles, but for a slightly different reason. Although the District Court based its decision on equitable considerations because it considered the policy language unambiguous, the Fifth Circuit ruled its decision in *Clemtex, Inc. v. Southeastern Fidelity Insurance Co.*, 807 F.2d 1271 (5th Cir. 1987) provided clear precedential support for the District Court's conclusion. *Lafarge*, 61 F.3d at 401.

In *Clemtex*, the Fifth Circuit interpreted a "per claim" policy with regard to claims filed by numerous victims of silicosis. The Court determined Clemtex was responsible for one deductible for each victim. Noting that, under the equitable apportionment scheme adopted in the case, each insurance company was responsible for only a portion of Clemtex's liability, the Court stated:

> It follows that each insurer herein has been demanding a full deductible for a partial claim. The insurance policies do not clearly so provide. Clemtex, on the other hand, urges this Court to construe the policies to provide for a reduced deductible to reflect each insurer's apportioned indemnification liability . . .. Yet the policies do not expressly provide for reduced deductibles.

Clemtex, 807 F.2d at 1276-77. The Fifth Circuit then remanded the action to the district court for a resolution of the ambiguity in the policy language. *Id.* at 1277.

Based on its reasoning in *Clemtex*, the Fifth Circuit in *Lafarge v. Hartford* concluded the deductible provisions of the Hartford policy were also ambiguous because they did not address a situation in which defense costs were apportioned. *Id.* at 61 F.3d at 401. The Fifth Circuit decided that when such ambiguity exists, a district court "[does] not have to rely on equitable principles in order to reduce the deductible obligation; its decision is supported simply as a valid choice of one of at least two reasonable interpretations of the policy." *Id.*; *see also Nationwide Mut. Ins. Co. v. Lafarge Corp.*, 910 F. Supp. 1104 (D. Md. 1996); aff'd, 121 F.3d 699 (4th Cir. 1997)(adopting proration of deductibles under Texas law).

1. Joint and Several Liability

As mentioned above, other courts have applied a joint and several theory (or vertical exhaustion) theory when apportioning defense, indemnity, and deductible costs. Under this theory, the insured can unilaterally select the policy that must respond fully up to the policy limits. Because the insured can pick and choose which policy to "trigger," the question of deductible apportionment is moot.

The seminal case applying this theory is *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981), cert. denied, 455 U.S. 1007 (1982). In *Keene*, which was the first decision to apply the joint and several allocation approach from the context of asbestos-related

bodily injury claims, the court held that each insurer on the risk between the initial exposure and the manifestation of the disease was liable to the insured. Once an insurer's policy was triggered, the court determined the insurer was required to defend and indemnify the policyholder to the extent of its entire policy limits, even though part of the injury may have occurred during other policy periods, including when the policyholder was self-insured. The insurer chosen to respond, however, could invoke the "other insurance" clause in its policy or invoke the equitable doctrine of contribution to allocate the liability among all triggered policies. *See also J.H. France Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502 (Pa. 1993).

This method, however, has some inherent problems. By allowing a joint and several approach, the court permits the insured to trigger periods of the insured's choosing thus minimizing the amount allocated to it. The insured will likely consider self-insured retentions, deductibles, limits of coverage, and availability of insurance in determining the period in which to request coverage.

In 1998, the Austin Court of Appeals issued its opinion in *Texas Property and Casualty Insurance Guaranty Ass'n v. Southwest Aggregates, Inc.*, 982 S.W.2d 600 (Tex. App—Austin 1998, no pet.), expressly disagreeing with these cases. *Southwest Aggregates* involved a coverage dispute between the Texas Property and Casualty Insurance Guaranty Association (as receiver for an insolvent insurer) and a solvent insurer concerning the scope of their respective obligations to defend an insured against numerous silicosis claims. It was undisputed that the policies issued by both the solvent and insolvent insurer were triggered by the underlying claims. The Austin Court of Appeals held each insurer whose policies are triggered by a long-term exposure claim are required to provide a full and complete defense to the claim and that the insured is entitled to select the policy under which it is to be defended. In so holding, the court stated:

> We agree with the Guaranty Association that Texas law follows *Keene* [*Corp. v. Insurance Co. of North America*, 667 F.2d 1034 (D.C. Cir. 1981) *cert. denied*, 455 U.S. 1007 (1982)]. The Texas Supreme Court has quoted *Keene* at length, citing it for the following propositions: (1) that concurrent coverage does not permit an insured to stack the limits of multiple policies that do not overlap, and (2) that the insured may select the policy under which it is to be indemnified. These principles are fully consistent with the notion that each of several insurers on concurrently triggered policies is obligated to provide a full defense to the insured. In addition, this Court has held [in *CNA Lloyds of Tex. v. St. Paul Ins. Co.*, 902 S.W.2d 657 (Tex. App.—Austin 1995, writ dism'd by agr.)] that an insurer's duty to indemnify its insured is not reduced when there is concurrent coverage among consecutive insurers, because there is nothing in the policies that provides for the reduction of the insurer's liability if an injury occurs only in part during a policy period. While [our prior holding] only decided the issue of allocating liability in the context of an insurer's duty to indemnify, we now hold the same rule applies to the duty to defend.
>
> ....

> Today we hold that under Texas law, an insurer's duty to defend its insured on a claim occurring partially within and partially outside of the policy period is not reduced pro rata by the insurer's "time on the risk" or by any other formula.

Id. at 605, 607 (citations and footnotes omitted). The court noted the insurer selected by the insured to defend the claims at issue may be entitled to a subsequent pro rata allocation of defense costs among all insurers whose policies are triggered by the claim. The court, however, stated that "the mechanism of pro rata apportionment among insurers does not affect the contractual relationship between the insurer and the insured that requires the insurer to provide full indemnification." *Id.* at 606; *see also Garcia*, 876 S.W.2d at 855 ("Once the applicable limit [of coverage] is identified, all insurers whose policies are triggered must allocate funding of the indemnity limit among themselves according to their subrogation rights.")

2. Fifth Circuit After *Southwest Aggregates*

The federal courts applying Texas law have not specifically addressed the impact of *Southwest Aggregates* on their earlier decisions adopting pro rata apportionment. These courts have, however, taken note of this decision. *See Azrock*, 211 F.3d 252 and n. 55 (remanding case for "briefing and determination on apportionment of coverage, if any," and citing *Southwest Aggregates* for the proposition that "Texas law does not require pro rata allocation of costs of defense"). Until the Texas Supreme Court squarely addresses it, the allocation issue is and will likely remain somewhat confused and uncertain.

G. Practical Considerations

The joint and several approach rests on an assumption that the insurer selected by the policyholder will be able to seek its contribution from the policyholders' carriers who were not selected via subrogation. In other words, when the selected insurer indemnifies the insured, it then becomes equitably entitled to recover its "overpayment" through subrogation from the other carriers who provided insurance to the insured over the period of the underlying plaintiffs' alleged injurious exposure. This derives from the principle that an insurer who covers its insured's loss is entitled to recover all or part of that loss from another responsible party, based on the latter's proportion of liability. In such instances, the insurer is "subrogated" to the insured's rights of recovery. This means that after payment is made on behalf of the insured the carrier is substituted for and stands in the insured's shoes.

But the simple joint and several principles espoused in *Southwest Aggregates* may not easily be applied in every situation. *Southwest Aggregates* involved only one primary insurer, Alliance, who sought a declaration that it should be able to share the cost of defense of its insured with the Texas Guaranty Association (the statutory receiver for one of the insured's insolvent carriers). What happens if the insured, after first proceeding on a horizontal bases with its insurers, changes its position and proceeds on a vertical bases. Second, and most significantly, to the extent an insured reaches (or has reached) a settlement with any of its primary and/or excess insurers, the equitable subrogation rights of the non-settling insurers will be destroyed. *See e.g., Hollen v. State Farm Mutual Automobile Insurance Co.,* 551 S.W.2d 46, 49 (Tex. 1977).

What remains unclear under Texas law is whether an insured can proceed vertically against the remaining insurance defendants after it has settled with and released other carriers and forfeited the "vertically selected" carriers' equitable subrogation rights. *See e.g. Koppers Co., Inc. v. Aetna Cas. Sur. Co.,* 98 F.3d 1440 (3rd Cir. 1996) (discussing the problems associated with joint and several approach). Under either a pro-rata or under a joint and several approach, an insurer should be liable for only its share, however calculated, of the over-all liability. *See, e.g., Koppers*, 98 F.3d at 1449-50; *Keene*, 667 F.2d at 1050. The only difference between these two theories is the time for performing the allocation: under the pro rata approach, allocation occurs when the loss is paid in the first instance; under the joint and several approach, by contrast, allocation occurs in a second lawsuit, when the loss becomes the subject of contribution among policies and insurers. Texas law, however, has not progressed to the point yet to discuss these subtle differences in complex multi-party insurance cases.

III. CONCLUSION

This paper was intended to identify recent issues that have been addressed by Texas courts as to trigger and allocation. The hope of this paper was to provide a small survey of recent Texas law which will be helpful as you come across similar coverage issues arising out of Texas law.

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THE EVOLUTION OF POLLUTION EXCLUSIONS

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THE EVOLUTION OF POLLUTION EXCLUSIONS

A. A Brief Historical Overview

In the late 1970s and early 1980s two major environmental laws were enacted that radically increased the importance of insurance coverage for pollution-related damage or injury. As environmental disasters such as Love Canal began to emerge, unprecedented liability was imposed on industry with the passage of the Resource Conservation and Recovery Act ("RCRA") and the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA").

RCRA regulated and monitored the life cycle of hazardous waste; CERCLA required anyone at all connected to the waste to pay for its cleanup. Liability was joint and several and applied without regard to fault. Practically overnight, pollution that had been tolerated for decades exposed businesses to massive financial loss.

Some of these businesses turned to their general liability insurers and requested defense and indemnity. Because the environmental liabilities involved large sums of money, many insurers balked at the coverage requests, and litigation followed.

1. The "Sudden and Accidental" Clause

The pollution exclusion became near and dear to insurers' hearts. The most common pollution exclusions in use at this time, however, contained an exception for pollution caused by a "sudden and accidental" event or, in the London market's wording, a "sudden, unintended and unexpected" happening. Here is an example:

> Notwithstanding any provision to the contrary in this policy, it is agreed that coverage does not extend to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, acids, alkalis, toxic chemicals, liquids or gasses, waste materials or other irritants, contaminants, pollutants into or upon land, the atmosphere or any watercourse or body of water or drainage system or sewer. However, this exclusion does not apply if such discharge, dispersal, release or escape is ***sudden and accidental.***

(Emphasis added). A debate ensued over the meaning of this phrase, particularly the term "sudden."

Insurers argued that the term "sudden" had a temporal connotation and meant "quick" or "abrupt." There had to be a "boom" event, such as a tank turnover, rupture or explosion. Where that argument was successful (as in Texas), the exclusion operated to preclude coverage for many environmental liabilities that were the result of years of accumulated contamination.

Insureds argued that the phrase "sudden and accidental" was ambiguous and really meant "unexpected or unintended."[1] In states where courts accepted this argument, insurers were ordered by courts to pay hundreds of millions in remediation costs.

These mixed results and mounting liabilities led the insurance industry to develop new pollution exclusions that would apply to a broader class of claims.

2. The Different Versions of the Total or Absolute Pollution Exclusion

The so-called "absolute" pollution exclusion resulted, and was designed totally to preclude coverage of environmental claims, with certain limited exceptions. By 1986, most general liability policies were issued with an absolute pollution exclusion, and some form of the exclusion is in most general liability policies issued today. The absolute pollution exclusion approved in 1986 by the Insurance Services Office ("ISO") provided:

> This insurance does not apply to:
>
> 1. Bodily injury or property damage arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants:
>
> A. At or from any premises, site or location which is or was at any time owned or occupied by, or rented or loaned to, any insured;
>
> B. At or from any premises, site or location which is or was at any time used by or for any insured or others for the handling, storage disposal, processing or treatment of waste;
>
> C. Which are or were at any time transported, handled, stored, treated, disposed of, or processed as waste by or for any insured or any person or organization for whom you may be legally responsible; or
>
> D. At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations:
>
> i. If the pollutants are brought on or in the premises, site or location in connection with such operations by such insured contractor or subcontractor; or

---

[1] Another argument was that, even if "sudden" is not ambiguous, courts should disregard, or insurers should be estopped to assert, the term's temporal connotation due to alleged misrepresentations by the insurance industry to state insurance regulators at the time the pollution exclusion was proposed. *See, e.g., Morton Int'l, Inc. v. General Accident Ins. Co.*, 629 A.2d 831 (N.J. 1993) (accepting the argument on public policy grounds).

ii. If the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effect of pollutants.

Subparagraph (d)(i) does not apply to bodily injury or property damage arising out of the escape of fuels, lubricants or other operating fluids which are needed to perform the normal electrical, hydraulic or mechanical functions necessary for the operation of "mobile equipment" or its parts, if such fuels, lubricants or other operating fluids escape from a vehicle part designed to hold, store or receive them. This exception does not apply if the fuels, lubricants or other operating fluids are intentionally discharged, dispersed or released, or if such fuels, lubricants or other operating fluids are brought on or to the premises, site or location with the intent to be discharged, dispersed or released as part of the operations being performed by such insured, contractor or subcontractor.

Subparagraphs (a) and (d)(i) do not apply to bodily injury or property damage arising out of heat, smoke or fumes from a hostile fire. As used in this exclusion, a hostile fire means one which becomes uncontrollable or breaks out from where it was intended to be.

2. Any loss, cost or expense arising out of any:

A. Request, demand or order that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of pollutants; or

B. Claim or suit by or on behalf of a governmental authority for damages because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effect of pollutants.

Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

Note the absence of a "sudden and accidental" exception. Insurers have used a variety of other "absolute pollution exclusions," but what makes them "absolute" – their common link -- is their omission of that exception. Most absolute pollution exclusions, like the one above, also typically dropped the language "into or upon the land, the atmosphere or any water course or body of water."

Though the absolute pollution exclusion was an improvement (from the insurers' perspective) over the "sudden and accidental" pollution exclusion, many pollution claims

continued to be covered under the absolute pollution exclusion because they fell outside of the exclusion's "premises" prong and other criteria. These claims became expensive. Several years later, the insurance industry developed the "total pollution exclusion," an even more restrictive provision, beginning in the 1990s. A common total pollution exclusion provides:

> [The policy excludes:]
>
> "Bodily injury" or "property damage" at ***any*** premises, site or location arising out of the actual, alleged, or threatened discharge, dispersal, release or escape of pollutants. This "bodily injury" or "property damage" that arises may be due to ***any*** of the insured's operations including those which produce a "products-completed operations hazard."
>
> Any loss, costs, or expense arising out of any governmental direction or request that you test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.
>
> Pollutants means any solid, liquid, gaseous, or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals, and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

(Emphasis added).

While the absolute or total pollution exclusions ended debate surrounding "sudden and accidental," they also sparked new controversy. *See* William P. Shelley & Richard C. Mason, Cozen O'Connor, *Application of the Absolute Pollution Exclusion to Toxic Tort Claims: Will Courts Choose Policy Construction or Deconstruction?*, 33 TORT & INS. L.J. 749 (1998). Although many courts pronounced the exclusion unambiguous and applied it broadly, even to incidents that are not classic environmental pollution, others found the clause to be ambiguous as applied to bodily injury arising out of a more direct contact with a substance that may fall into the exclusion's broad definition of "pollutant." Court opinions on both sides of that divide are discussed in more detail below.

3. The Introduction of Health Hazard Exclusions

More recently, insurers have made increasing use of provisions that, alone or as part of a pollution exclusion, preclude coverage for specific health hazards. For example, a pollution exclusion now in use by some insurers provides: "We will not cover bodily injury or property damage arising out of the actual, alleged or threatened discharge, dispersal, release, escape, seepage, trespass, wrongful entry, migration, ***ingestion, inhalation or absorption*** of pollutants from any source." *See Heringer v. American Family Mut. Ins. Co.*, 140 S.W.3d 100, 102 (Mo. App. 2004) (emphasis added) (applying the exclusion to bodily injury arising out of exposure to lead paint). The inclusion of the words "ingestion, inhalation or absorption" makes clear that the exclusion is not limited to environmental pollution. *Id.*

A free-standing health hazard exclusion in use by other insurers is entitled "Absorption/Inhalation/Disease Exclusion." It provides:

> This insurance does not apply to "bodily injury," "property damage," "personal injury," "advertising injury," disease or illness including death resulting from such disease or illness, alleged disease or illness, property damage, or any other damages, for past, present, or future claims arising in whole or in part, directly or indirectly, out of:
>
> 1. ***Any form of inhalation or absorption***[.]

(Emphasis added). This provision more broadly negates coverage than the above pollution-exclusion example, since it does not depend on the existence of pollution at all.

B. Use Of The Absolute Exclusion In "Non-Traditional" Pollution Cases

As mentioned above, insureds often argue that an absolute or total pollution exclusion should only apply to traditional environmental pollution, i.e., contamination of soil, water or atmosphere. The argument generally rests on the contention that a pollution exclusion cannot apply because there was no "release" or "discharge" of the subject material beyond its intended confines; that the terms "dispersal," "discharge," "irritant" or "contaminant" are terms of art in environmental law; that the "general purpose" of the exclusion is to shield insurers from the costs of environmental cleanups; or because a literal reading of the provision could yield "absurd results." *See Belt Painting Corp. v. TIG Ins. Co.,* 795 N.E.2d 15, 19 (N.Y. 2003) (discussing the various rationales).

This type of argument was accepted, for example, in *Doerr v. Mobil Oil Corp.*, 774 So. 2d 119 (La. 2000). In *Doerr*, the Louisiana Supreme Court held that an absolute pollution exclusion applies only to traditional environmental pollution, and, thus, would not apply to bodily injury and property damage allegedly resulting from disposal of contaminated water through the local drinking water system. In the court's view, the true intent of the pollution exclusion is to exclude coverage for environmental pollution only, and a broader or more literal reading of the exclusion would lead to "absurd consequences." *Doerr*, 774 So. 2d at 124. The court remanded the case for a determination of whether the insured was a "polluter" (in the environmental sense), whether the contaminants at issue were "pollutants," and whether distribution of the water through the parish system constituted a "discharge, dispersal, seepage, migration, release or escape" within the exclusion's meaning. *Id.* at 135-36.

More recently, another Louisiana state court followed *Doerr* and held that a total pollution exclusion did not preclude coverage for an aggravated allergic reaction to mold, mildew and other allergens caused by an influx of water into the building where the plaintiff worked during roof repairs. *See also State Farm Fire & Cas. Co. v. M.L.T. Constr. Co.*, 849 So. 2d 762 (La. App. 2003).

Although some other courts have also accepted these arguments[2] (and some have rejected them[3]), the arguments are not proving effective in Texas. Texas courts have rejected the

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2 *Keggi v. Northbrook Prop. & Cas. Ins. Co.*, 13 P.3d 785 (**Ariz.** Ct. App. 2000) (injuries from bacteria-contaminated water did not fall within absolute pollution exclusion; exclusion is limited to environmental pollution); *Minerva Enterprises, Inc. v. Bituminous Cas. Corp.*, 851 S.W.2d 403 (**Ark.** 1993) (property damage caused by a sewage backup from a septic tank in a mobile park not excluded; "waste" used in the pollution exclusion refers to industrial waste, not household waste); *MacKinnon v. Truck Ins. Exch.*, 73 P.3d 1205 (**Cal.** 2003) (injury from pesticides not excluded; absolute pollution exclusion limited to environmental pollution); *American States Ins. Co. v. Koloms*, 687 N.E.2d 72 (**Ill.** 1997) (bodily injury caused by carbon monoxide poisoning from a defective furnace not excluded; pollution exclusion does not apply to "non-environmental" claims); *Pipefitters Welfare Ed. Fund v. Westchester Fire, etc., et al.*, 976 F.2d 1037 (7th Cir. 1992) (agreeing that pollution exclusion applies only to environmental injuries but finding that the harm at issue (PCB contamination from electric transformer) did qualify as environmental and thus was excluded); *West Bend Mut. Ins. Co. v. Iowa Iron Works, Inc.*, 503 N.W. 2d 596 (**Iowa** 1993) (damage from sand disposed of off site not excluded; absolute pollution exclusion limited to environmental pollution); *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65 (**Kan.** 1997) (smoke from hostile fire not excluded; absolute pollution exclusion limited to environmental pollution); *Nautilus Ins. Co. v. Jabar*, 188 F.3d 27 (1st Cir. 1999) (construing **Maine** law) (bodily injury arising from exposure to fumes emitted from roofing products used in roofing repair not excluded; "an ordinarily intelligent insured could reasonably interpret the pollution exclusion clause as applying only to environmental pollution"); *Sullins v. Allstate Ins. Co.*, 667 A.2d 617 (**Md.** App. 1995) (bodily injury arising from exposure to lead paint not excluded; the words "contaminants" and "pollutants" are susceptible to two interpretations by a reasonably prudent layperson – one interpretation is that these terms only apply to traditional environmental pollution, not to products such as lead paint); *Western Alliance v. Singh*, 686 N.E.2d 997 (**Mass.** 1997) (bodily injury arising from exposure to carbon monoxide fumes at a restaurant not excluded; the pollution exclusion only applies to traditional environmental pollution); *Enron Oil Trading v. Walbrook Ins. Co.*, 132 F.3d 526 (9th Cir. 1997) (construing **Montana** law) (property damage caused by the injection of foreign substances into a pipeline carrying crude oil to a refinery not excluded; the undefined term "contamination" refers to environmental-type harms); *Belt Painting Corp. v. TIG Ins. Co.*, 795 N.E.2d 15 (**N.Y.** 2003) (absolute pollution exclusion only applies to environmental pollution and does not preclude coverage for bodily injury arising out of office worker's inhalation of paint or solvent fumes); *Kent Farms, Inc. v. Zurich Ins. Co.*, 998 P.2d 292 (**Wash.** 2000) (exposure to diesel fuel from back-flow due to faulty intake valve not excluded; absolute pollution exclusion limited to environmental pollution); *Gainsco Ins. Co. v. Amoco Production Co.*, 53 P.3d 1051 (**Wy.** 2002) (death caused by inhalation of hydrogen sulfide gas at an oil field not excluded; Court stated that it "cannot believe that any person in the position of the insured would understand the word "pollution" in this exclusion to mean anything other than environmental pollution).

3 *Shalimar Contractors, Inc. v. American States Ins. Co.*, 975 F. Supp. 1450, 1457 (N.D. **Ala.** 1997) (absolute pollution exclusion is not limited to pollution of the environment resulting from industrial activity); *Connecticut Resources Recovery Authority v. Transcontinental Ins. Co.*, 1999 WL 49486 (**Conn.** Super. Ct. 1999) (under absolute pollution exclusion, it is immaterial whether there is environmental contamination); *National Electric Mfrs. Assoc. v. Gulf Underwriters Ins. Co.*, 162 F.3d 821, 824-826 (4th Cir. 1998) (construing **District of Columbia** law) (absolute pollution exclusion is not limited to atmospheric or environmental pollution, but must be enforced as written); *Admiral Ins. Co. v. Feit Mgt. Co.*, 321 F.3d 1326, 1329-30 (11th Cir. 2003) (construing **Florida** law) (injuries to apartment residents from carbon monoxide exposure via apartment heating system fell within pollution exclusion); *Atlantic Ave. v. Central Solutions*, 24 P.3d 188 (**Kan.** App. 2001) (Property damage caused by a leaking drum of cement cleaner in a warehouse was excluded; discharge need not occur into the "public environment"); *Bernhardt v. Hartford Ins. Co.*, 648 A.2d 1047, 1052 (**Md.** Ct. Spec. App. 1995) (absolute pollution exclusion draws no distinction between intentional and non-intentional discharge of pollutants; nor does it in any manner suggest that only chronic emission of the defined pollutants is excluded from coverage); *McKusick v. Travelers Indem. Co.*, 632 N.W.2d 525 (**Mich.** App. 2001) (bodily injury caused by exposure to chemical used in the manufacture of polyurethane foam was excluded; there is no "environmental pollution" limitation in the policy); *Board of Regents v. Royal Ins. Co.*, 517 N.W.2d 888, 893-894 (**Minn.** 1994) (pollution exclusion precludes coverage for contamination of a building's air by asbestos fibers); *American States Ins. Co. v. Nethery*, 79 F.3d 473, 474 (5th Cir. 1996) (construing **Mississippi** law) (absolute pollution exclusion precludes coverage for injuries caused by fumes from standard paint and glue materials); *Hartford Underwriters Ins. Co. v. Turks*, 206 F. Supp. 2d 968, 975-77 (E.D. **Mo.** 2002) (pollution exclusion is not limited to environmental pollution and applies to exposure to lead paint through ingestion or inhalation); *Cincinnati Ins. Co. v. Becker Warehouse, Inc.*, 635 N.W.2d 112 (**Neb.** 2001) (rejecting argument that the pollution exclusion only applies to traditional "environmental" claims); *Zell v. Aetna Casualty & Surety Co.*, 683 N.E.2d 1154, 1156 (**Ohio** Ct. App. 1996) (absolute pollution exclusion bars coverage even when material which causes contamination is not a "pollutant" when it is brought on site, but subsequently emits noxious fumes); *Bituminous Cas. Corp. v. Cowen Constr., Inc.*, 55 P.3d 1030, 1034-35 (**Okla.** 2002) (pollution exclusion is not limited to environmental pollution and therefore can apply to lead poisoning from lead in building); *Mark I Restoration SVC v. Assurance Co. of Am.*, No. 02-3729, 2003 WL 1036557, at *6-8 (E.D. **Pa.**, Mar. 12, 2003) (allegation that insured misapplied "chemicals, deodorizers, odor eliminators and/or other foreign substances" fell within pollution exclusion); *Cook v. Evanson*, 920 P.2d 1223, 1226 (**Wash.** App. 1996) (absolute pollution exclusion is not limited to cases of traditional environmental pollution).

contention that a "release" or "discharge" within an intended area is not a release or discharge, and have readily applied absolute or total pollution exclusions to non-environmental pollution, both inside and outside of the workplace. The overriding perspective of Texas courts is as stated by the Texas Supreme Court: the absolute pollution exclusion is unambiguous and "is just what it purports to be -- absolute." *See National Union Fire Insurance Company v. CBI Industries, Inc.*, 907 S.W.2d, 517, 522 (Tex. 1995) (refusing to permit parole evidence on the insurance industry's development of the absolute pollution exclusion, or discovery designed to obtain such evidence, where the insured could not demonstrate the exclusion was ambiguous or why its plain wording should not control).

1. Workplace Exposure

One of the first courts to address Texas law on the environmental versus non-environmental pollution issue, in the work context, was the United States Court of Appeals for the Fifth Circuit in *Certain Underwriters at Lloyd's, London v. C.A. Turner Constr. Co.*, 112 F.3d 184 (5th Cir. 1997). In *Turner*, the court held that an absolute pollution exclusion barred coverage for injuries suffered by worker who was injured when discharge of phenol gas filled tent in which he was welding pipe, even though release was confined to that area. *Turner*, 112 F.3d at 187-88. The insured argued against this result on the ground that the exclusion was designed to apply only to clear traditional environmental pollution rather than workplace accidents. The court rejected the argument in reliance upon one of its own cases decided under Mississippi law, as well as the Texas Supreme Court's *CBI* ruling:

> Guided by the language of the pollution exclusion clause and the Texas Supreme Court's decision in *CBI,* we conclude that coverage for damage resulting from the release of phenol gas is likewise excluded. . . . The clause does not limit its application to only those discharges causing environmental harm; in contrast, it speaks broadly of "[l]iability for ***any*** bodily or personal injury." This language is not ambiguous; a plain reading of the clause dictates the conclusion that all damage caused by pollution, contamination, or seepage is excluded from coverage. . . . Here, Galbreath's injuries stemmed from the discharge of phenol gas that contaminated the air inside the tent enclosing the scaffolding; the release of the toxic chemical allegedly rendered him unable to breathe. Thus, the phenol gas emission constituted bodily-injuring pollution or contamination, and coverage for C.A. Turner's claim is precluded under the pollution exclusion clause.

Id. (footnotes and most citations omitted; emphasis supplied in original).

The Fifth Circuit acknowledged "the difficulty inherent in defining the scope of a pollution exclusion clause when the damage-causing incident involves a commonly used chemical or when only a slight amount of substance is released." *Id.* at 188. It quoted a Seventh Circuit case and its -- now somewhat famous -- "Drano" example:

> The terms "irritant" and "contaminant," when viewed in isolation, are virtually boundless, for "there is virtually no substance or chemical in existence that would not irritate or damage some person or property."

> Without some limiting principle, the pollution exclusion clause would extend far beyond its intended scope, and lead to some absurd results. To take but two simple examples, reading the clause broadly would bar coverage for bodily injuries suffered by one who slips and falls on the spilled contents of a bottle of Drano, and for bodily injury caused by an allergic reaction to chlorine in a public pool. Although Drano and chlorine are both irritants or contaminants that cause, under certain conditions, bodily injury or property damage, one would not ordinarily characterize these events as pollution.

Id. (quoting *Pipefitters Welfare Educ. Fund v. Westchester Fire Ins. Co.*, 976 F.2d 1037, 1043 (7th Cir. 1992)). Although the Fifth Circuit agreed with "the Seventh Circuit's common-sense approach," it did not believe that its conclusion offended the approach in view of the substantial nature of the discharge that occurred in the *Turner* case. The underlying plaintiff, Galbreath, had testified that, once the rags were removed from the pipe, "it was just like somebody . . . . threw a smoke bomb in there. I couldn't even see -- couldn't see a hand in front of your face." The emission of the harmful fumes, the Fifth Circuit explained, "filled up a temporary plastic tent that enclosed scaffolding intended to support at least three people. The scope of this release distinguishes it from the Seventh Circuit's example of the spill of a bottle of Drano and supports our conclusion." *Id.* at 188.

More recently, in *Hamm v. Allstate Ins. Co.*, 286 F. Supp. 2d 790, 793-94 (N.D. Tex. 2003), the United States District Court for the Northern District of Texas applied an absolute pollution exclusion to some office-building tenants' bodily injury claims against the insured building owners that arose from exposure to chemical fumes from a bathroom remodeling project. The tenants contended that

> Allstate cannot prove that an ordinary person strictly construing Allstate's pollution exclusion . . . would conclude that bathroom fumes are pollution. Ordinary people think of pollution as the broadcasting of harmful solids, liquids and gases into the environment: 'Smokestack pollution.' Pipes dripping fluid into rivers. Leaking drums of chemicals.

Hamm, 286 F. Supp. 2d at 794 n.2. The court rejected this contention based on the language of the exclusion:

> The problem with [the tenants'] argument, however, is that the policies specifically define the term 'pollutants' to include '**any** irritant or contaminant, including . . . fumes . . . .' Thus, the policies specifically and unambiguously define the term 'pollutants' broadly enough to encompass the toluene fumes that caused [tenants'] injuries.

Id. (emphasis supplied in original).

The court also rejected the argument that the tenants' artful pleading of "accumulation" of fumes, rather than discharge, release, etc., would render the exclusion inapplicable. Whatever the terms selected, the substantive allegation was that the tenants were exposed, "while in their fifth-floor office, to fumes from chemicals applied in the fifth-floor bathroom during a

remodeling project." *Id.* at 794. "The only way those fumes could have affected [the tenants] in their office," the court explained, "is if the fumes first were either discharged, dispersed, or released from the bathroom or escaped, seeped, or migrated from the bathroom into [their] office." *Id.* at 794-95. Moreover, "the pollution exclusions apply to more than just the dispersal of pollutants **from** the building. The exclusions specifically provide that coverage is excluded when pollutants are dispersed or released '**at** . . . [the] premises.'" *Id.* at 795 n.4 (emphasis supplied in original). To interpret the exclusion as applying only to generalized dispersal into the environment would be to ignore the use of the word "at" in the exclusion. *Id.*

Consistent with *Turner* and *Hamm*, the San Antonio Court of Appeals ruled in my client's favor in *Zaiontz v. Trinity Universal Ins. Co.*, 87 S.W.3d 565, 571-72 (Tex. App.—San Antonio 2002, pet. denied) that a worker's use of a fogger to spray an odor eliminator in the interior of an airplane caused a "discharge," "dispersal," or "release" within the meaning of the absolute pollution exclusion even though the product was not moved from the intended location. The claimant zealously fought this decision all the way to the Texas Supreme Court, which solicited extensive briefing from both sides, but ultimately refused to grant the petition for review. The Northern District of Dallas subsequently cited *Zaiontz* as additional support for the *Hamm* decision outlined above. *See Hamm*, 286 F. Supp. 2d at 795-96.

Other examples of cases in which courts have applied an absolute or total pollution exclusion to non-environmental pollution, where the bodily injury or property damage arose from workplace exposure, are as follows:

- *Amoco Production Co. v. Hydroblast*, 90 F. Supp 2d 727 (N.D. Tex. 1999) (pollution exclusion in general liability policy precluded coverage for employees' exposure to cleaning solvent)

- *Crown Central Petroleum Corp. v. Rust Scaffold Builders, Inc.*, 951 F. Supp. 636, 640 (S.D. Tex. 1996) ("The absolute pollution exclusion excludes coverage . . . because [the underlying plaintiffs] alleged in their pleadings that they sustained bodily injuries as a result of exposure to airborne hydrofluoric acid in a battery unit within Crown's plant.")

- *See also Clarendon Am. Ins. Co. v. Bay, Inc.*, 10 F. Supp. 2d 736 (S.D. Tex. 1998), discussed below under section 3(a) ("Silica").

2. Exposure In Other Environments

Although most cases of so-called "non-traditional" pollution arise in the work context, the logic of the foregoing authorities carries over into non-industrial situations as well:

- *Allen v. St. Paul Fire & Marine Ins. Co.*, 960 S.W.2d 909, 912 (Tex. App. –Texarkana 1998, no pet.) (claims against insured water utility, that water was contaminated, nonpotable, of poor quality, and unfit for residential use, were barred from coverage by absolute pollution exclusion because they constituted claims of contamination).

- *Northbrook Indem Ins. Co. v. Water Dist. Management Co.,*. Inc. 892 F. Supp. 170, 173 (S.D. Tex. 1995) (coverage for residents' alleged injury from exposure to well water contaminated with toxic and hazardous substances, including benzene, was barred by absolute pollution exclusion of water district management company's policy; residents' claims arose out of discharge of pollutants that escaped from well operated and tested by company).

- *See also Lexington Ins. Co. v. Unity/Waterford-Fair Oaks*, No. 3:99-CV-1623-D (N.D. Tex. 2002), discussed below under section 3(b) ("Mold").

3. Specific Substances

Some of the pollutants or substances that have been the subject of frequent or recent litigation in this area are silica, asbestos, lead paint and mold. Those substances are addressed separately below.

(a) Silica

In *Clarendon Am. Ins. Co. v. Bay, Inc.*, 10 F. Supp. 2d 736, 743-44 (S.D. Tex. 1998), the United States District Court for the Southern District of Texas reached a "mixed coverage result" when addressing a total pollution exclusion's applicability to work-related silica exposure. The exposure consisted of (i) inhalation of airborne silica dust and (ii) skin contact with silica-containing wet cement. The court held that the pollution exclusion unambiguously applied to the former, but was ambiguous and, thus, inapplicable, to the latter.

The insured argued that the exclusion should apply to neither type of exposure because the terms "pollution," "discharge" and "dispersal" are terms of art connoting environmental contamination, and neither the silica itself nor the modes of exposure fell within the terms. The court rejected this argument both as to the pollutant status of silica and as to the alleged necessity of environmental harm, though it found that there may have been no "discharge" or "dispersal" as to the skin contact exposure.

Regarding silica's status as a "pollutant," the court began with the policy language and the Texas Supreme Court's *CBI* decision, found no basis for deeming "pollutant" a term of art, and concluded:

> This Total Pollution Exclusion excludes coverage for "'bodily injury' or 'property damage' which would not have occurred . . . but for the discharge, dispersal, seepage, migration, release or escape of pollutants at any time. . . . Pollutants means ***any*** solid, liquid, [or] gaseous . . . ***irritant*** or ***contaminant*** including smoke, vapor, soot, fumes, acid, alkalis, chemicals, and waste." On its face, this exclusion presents no patent ambiguity. "[M]ost courts which have examined the same or substantially similar absolute pollution exclusions have concluded that they are clear and unambiguous." *CBI,* 907 S.W.2d at 521.
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> * * *

> Bay's term of art argument is unavailing. Bay has not cited, nor has research revealed, any state or federal cases construing these words as terms of art under Texas law. To the contrary, the Fifth Circuit has taken a broader view of these exclusions, and has found they are not limited in application to traditional environmental pollution -- releases that cause widespread environmental harm. Therefore, contrary to Bay's argument, Texas state and federal courts have not explicitly recognized the word "pollution" as a term of art.
>
> Nor is Bay's argument that sand, gravel, cement, and silica are raw materials, by-products, or end-products that do not appear on Environmental Protection Agency lists dispositive. "[N]umerous courts have found substances constituted pollutants regardless of their ordinary usefulness." Thus, silica is within the ambit of "pollution" as defined in this provision.

Clarendon, 10 F. Supp. 2d at 743-44 (underlining added; other emphasis supplied in original; footnotes and some citations omitted). In a footnote, the court further noted that the United States Supreme Court has recognized silica dust as an industrial pollutant. *Id.* at 744 n.3 (citing *Washington Metropolitan Area Transit Auth. v. Johnson,* 467 U.S. 925 (1984 and regulations promulgated as part of the Occupational Safety and Health Act characterize silica dust and other mineral dusts as "air contaminants" that must be regulated)).

The court likewise ruled that the terms "discharge" and "dispersal" are not ambiguous and applied to most of the underlying claims. One group of plaintiffs alleged that they suffered injuries "as a result of contacting and inhaling the toxic ingredients, dust, and particulates." *Clarendon*, 10 F. Supp. 2d at 744. Another group of plaintiffs alleged that "[a]s they contact and inhale the dust, sand, gravel, and other particulates, [they] come into contact with substances that give rise to injury to their respiratory system, nervous system, and cause brain damage." *Id.* Accordingly, the court ruled, "both sets of tort plaintiffs allege that they have suffered bodily injury and property damage from the 'discharge, dispersal, . . . migration, release or escape of pollutants,' namely dust, sand, gravel, tile, concrete, cement, silica, fumes, and other particulates, which qualify as 'solid [or] gaseous . . . irritant[s] or contaminant[s].'" *Id.*

Finally, the court found a latent ambiguity as to the exclusion's applicability to the skin contact claims. One group of plaintiffs alleged that they "often expose different portions of their bodies to the wet cement," and "contact wet cement." *Id.* Another group alleged that they "often expose different portions of their bodies to the wet cement and concrete." *Id.* The court found itself unable to "ascertain definitively from these pleadings whether the bodily injury caused by such contact or exposure occurred when the plaintiffs' skin touched the wet cement and concrete while the cement and its ingredients were in the cement's intended container or location, in which case resulting injuries did not stem from the 'discharge, dispersal, seepage, migration, release or escape of pollutants.'" *Id.* Accordingly, although the court granted summary judgment to the insurer as to all claims of injury caused by the discharge or dispersal of pollutants, it denied summary judgment for injuries caused by direct contact with wet cement.

(b) Mold

In *Lexington Insurance Co. v. Unity/Waterford-Fair Oaks*, No. 3:99-CV-1623-D, 2002 WL 356756 (N.D. Tex. Mar. 5, 2002), the United States District Court for the Northern District of Texas held that a first-party policy's pollution exclusion applied to the insured's claims for repair and abatement of mold damage caused by flooding and rain damage to an apartment complex. The pollution exclusion excepted from coverage the "release, escape, discharge or dispersal" of pollutants and defined "contaminants and pollutants" to included "bacteria, fungi, virus" and other hazardous substances that can cause or threaten to damage human health or damage to property. The insurer argued that the mold that had damaged the apartments clearly fell within this definition. The insured, however, argued that the mold had not been released, discharged or dispersed, nor did it escape, making the exclusion inapplicable. The case was tried to the court on stipulated facts.

The court looked to the insurer's expert testimony to decide whether the policy's pollution exclusion applied. The expert testimony was that mold reproduces by discharging spores into the air, as well as volatile chemicals called mycotoxins, which can be dangerous to human health. The insured countered that mold exists in all areas and merely thrives in particular spots because of moisture. Unpersuaded by the insured's arguments, the court found that the mold was a fungus that was dispersed into the apartments and that all damages arising from this dispersal fell within the policy's pollution exclusion. Based upon these findings, the court granted a declaratory judgment in favor of the insurer.

(c) Asbestos

No Texas courts have addressed whether an absolute pollution exclusion may apply to asbestos-related bodily injury or property damage. Outside of Texas, courts have reached divergent conclusions on this issue, but the conclusions generally result from each state's position on the environmental versus non-environmental pollution issue addressed above. Examples of those decisions are set out below. Because the authorities previously discussed place Texas among the states that apply absolute pollution exclusions to non-environmental property damage, the authors believe that a Texas court would readily apply a pollution exclusion in the asbestos context.

— **Cases finding a pollution exclusion applicable to asbestos:**

- *A-One Oil, Inc. v. Massachusetts Bay Ins. Co.*, 250 A.D.2d 633 (N.Y. App. Div., 1998) (holding that (1) absolute pollution exclusion clause unambiguously applied because asbestos is a type of irritant or contaminant and the underlying complaint alleged damages as a result of the release, dispersal, or discharge of pollutants either at or from a site at which the insured was removing pollutants, and (2) fact that asbestos was released in the basement of the homeowners' residence did not bring the claim outside the scope of the exclusion because indoor air contamination constituted environmental pollution).

- *American States Ins. Co. v. Zippro Constr. Co.*, 455 S.E.2d 133 (Ga. App. 1995) (holding that asbestos is a "pollutant" within terms of absolute pollution exclusion and that the exclusion applies unintended and unexpected releases because the exclusion is not limited by intent or foreseeability)

- *Board of Regents v. Royal Ins. Co.*, 517 N.W.2d 888, 893-894 (Minn. 1994) (pollution exclusion precludes coverage for contamination of a building's air by asbestos fibers).

- *Great N. Ins. Co. v. Benjamin Franklin Fed. Sav. & Loan Ass'n*, No. 90-35654, 1992 U.S. App. LEXIS 1593 (9th Cir., Jan. 31, 1992) (not designated for publication) (construing Oregon law) ("Asbestos is a pollutant as defined by the policy because it is a solid irritant."), *aff'g* 793 F. Supp. 259 (D. Or. 1990).

— **Cases finding a pollution exclusion inapplicable to asbestos:**

- *Continental Cas. Co. v. Rapid-American Corp.*, 609 N.E.2d 506 (N.Y. 1993) (asbestos-related injuries not excluded; terms used in the exclusion such as "discharge" and "dispersal" are environmental terms of art which refer to disposal of hazardous waste)

- *Essex Ins. Co. v. Avondale Mills, Inc.*, 639 So. 2d 1339 (Ala. 1994) (pollution exclusion inapplicable because "atmosphere" does not include "internal environs or surroundings of individual buildings").

(d) Lead Paint

No Texas courts have addressed whether an absolute pollution exclusion may apply to lead paint-related bodily injury or property damage. As with asbestos, non-Texas courts have reached divergent conclusions on the matter, generally in line with each state's position on the environmental versus non-environmental pollution issue. Here are some examples of those decisions:

— **Cases finding a pollution exclusion applicable to lead paint:**

- *Hartford Underwriters Ins. Co. v. Turks*, 206 F. Supp. 2d 968, 975-77 (E.D. Mo. 2002) (pollution exclusion is not limited to environmental pollution and applies to exposure to lead paint through ingestion or inhalation)

- *Bituminous Cas. Corp. v. Cowen Constr., Inc.*, 55 P.3d 1030, 1034-35 (Okla. 2002) (pollution exclusion is not limited to environmental pollution and therefore can apply to lead poisoning from lead in building)

— **Cases finding a pollution exclusion inapplicable to lead paint:**

- *Sullins v. Allstate Ins. Co.*, 667 A.2d 617 (Md. App. 1995) (bodily injury arising from exposure to lead paint not excluded; the words "contaminants" and "pollutants" are susceptible to two interpretations by a reasonably prudent layperson – one interpretation is that these terms only apply to traditional environmental pollution, not to products such as lead paint)

- *Atlantic Mutual Ins. Co. v. McFadden*, 595 N.E.2d 762 (Mass. 1992) (bodily injury as a result of lead exposure not excluded; the pollution exclusion does not apply because the terms used in the pollution exclusion are terms of art in environmental law which refer to damage caused by improper disposal of hazardous waste, not a child's exposure to lead)

- *Sphere Drake Ins. Co. v. Y.L. Realty Co., et al.*, 990 F. Supp. 240 (N.D.N.Y. 1997) (lead poisoning from flaking paint at an apartment building not excluded; pollution exclusion only applies to "industrial and environmental pollution," because the exclusionary language uses "terms of art in environmental law").

C. Whether Extrinsic Evidence May Be Used To Create Or To Deny A Duty To Defend In Pollution Exclusion Cases

Pollution exclusions generally depend, for their applicability, on several stated predicates and conditions, and may be subject to exceptions, as discussed in the preceding sections. What may insurers, insureds and courts consider when determining whether the various predicates, conditions and/or exceptions are fulfilled? Must all coverage determinations rest solely on the content of the insurance policy and the complaint or petition against the insured, or may they also take into account extrinsic evidence?

Two cases, both out of the Fifth Circuit, have directly considered whether Texas law permits extrinsic evidence in determining the applicability of a pollution exclusion, and both have ruled in the affirmative. Those cases are addressed below. Because the cases are not entirely consistent with prior state and federal court decisions, however, we will follow up with a discussion of those prior decisions, and then conclude with a few practice pointers.

1. The *Primrose* and *Vic Manufacturing* Cases

The two Fifth Circuit cases that have addressed the use of extrinsic evidence in the pollution exclusion context are *Primrose Operating Company v. National Am. Ins. Co.*, No. 03-10861, 2004 U.S. App. LEXIS 17895 (5th Cir., Aug. 23, 2004) and *Guaranty Nat'l Ins. Co. v. Vic Mfg. Co.*, 143 F.3d 192 (5th Cir. 1998). The *Primrose* case involved a policy with both an absolute pollution exclusion and a separate "pollution endorsement" that negated the pollution exclusion where certain conditions were met. The court allowed the insured to use extrinsic evidence to create a duty to defend. The *Vic Manufacturing* case, on the other hand, involved a "sudden and accidental" pollution exclusion, and the beneficiary of the extrinsic evidence was the insurer, not the insured.

In *Vic Manufacturing*, the plaintiff drafted a petition describing slow, gradually occurring pollution as "sudden and accidental," in an effort to avoid application of a "first generation" pollution exclusion clause. 143 F.3d at 194. The plaintiff listed in its answers to interrogatories, however, that there were "seventy-seven spills at nineteen of the facilities occurring over a period of approximately forty years. Several of the listed spills actually [were] multiple spills, so that the . . . pollution [was] the result of over a hundred separate events." *Id.* at 195. On this evidence, the Fifth Circuit allowed the insurer to contradict the characterization in the petition. *Id.* The court held that the insured could not "create a duty to defend by microanalyzing the case and finding a single spill that may have been 'sudden and accidental.'" *Id.* In reaching this conclusion, the court relied on a pollution exclusion in the policy that prevented coverage "where the insured has engaged in the deliberate discharge of contaminants in the routine course of business over many years." *Id.* Because of this exclusion, "the fact that the insured may have also experienced isolated spills or minor accidents over the same period is irrelevant." *Id.*

More recently, on August 23, 2004, the Fifth Circuit released its opinion in *Primrose* and held that extrinsic evidence may be considered in determining a duty to defend "if the petition does not contain sufficient facts to enable the court to determine if coverage exists." 2004 U.S. App. LEXIS 17895 at *7-8. The specific issue upon which the court considered extrinsic evidence was whether the conditions of a "pollution endorsement" were fulfilled, in which case the policy's absolute pollution exclusion would not apply. There were six conditions in the pollution endorsement, three of which the parties agreed were fulfilled, and three of which the insurer argued had not been satisfied. The latter three conditions were that (1) the "pollution incident" be "sudden and accidental and . . . neither expected nor intended by any insured"; (2) the injury or damage from the pollution incident must "not [be] caused or contributed to in any degree prior to the beginning of the policy period"; and (3) the pollution incident must "not result from or [must not be] contributed by [the insured's] failure to comply with any government statute, rule, regulation, or order." *Id.* at *12. The court found that the applicability of the first two conditions could not be determined from the underlying pleadings alone and that, therefore, extrinsic evidence should be considered. *Id.* at *12-23.

Regarding the "sudden and accidental" condition, the court began by reiterating that "[t]he temporal requirement of 'sudden and accidental' requires that the pollutant be released quickly. Texas law defines 'sudden' as an abrupt or brief event." *Id.* at *16. The underlying claimants, members of the Senn family, alleged that the insureds had polluted their ranch when they operated an oil and gas lease from 1992 to 1999. *Id.* at *2. The Senns did not allege whether "any of the pollution incidents resulted in a quick or sudden release of damaging pollutants," however. "[T]herefore," the court ruled, "it is impossible to discern from the complaint alone if the 'sudden' requirement is satisfied . . . [and] it is proper to look to extrinsic evidence to determine whether the Senns' claims were potentially covered by the policy." *Id.* at *15 (citation omitted).

The court described the specific extrinsic evidence as follows:

> [T]here was testimony elicited at trial revealing that the oil companies' flow lines carry their contents under extreme pressure and that when the lines burst, the event occurs suddenly, sometimes resulting in a spray of water as high as forty feet in the air. There was also testimony

> establishing that the pressure in the tank batteries and flow lines were checked at least daily, therefore, [the insureds] were made aware of any compromise in the production equipment almost immediately. While the breaks causing the leaks and spills were undoubtedly caused by conditions created over a number of years, the policy's "sudden" requirement is satisfied as long as the actual break is "sudden and accidental." This evidence supports the jury's finding that at least one of the alleged spills could have potentially occurred suddenly.

Id. at *19. In view of this evidence, the court deemed the "sudden and accidental" condition in the pollution endorsement satisfied.

Regarding the condition that damage not be caused or contributed to by pre-policy pollution incidents, the court wrote:

> Because the Senns do not specifically allege when the pollution incidents occurred, it is impossible to determine from the pleadings alone whether any pollution incident occurred during NAICO's coverage of Primrose. This court, therefore, may look to extrinsic evidence to answer this question. As the parties have stipulated that some spills occurred after April 1, 1999, i.e., when NAICO's coverage of Primrose began, and because NAICO does not contend there were no pollution incidents that occurred during its coverage of Primrose, the allegations represent claims that are potentially covered by NAICO's policy. Because Plaintiffs have established coverage during all relevant time periods, they have accordingly satisfied the requirements for Condition d.

Id. at *23-24.

In view of the *Vic Manufacturing* and *Primrose* decisions, an insurer or insured would have a solid basis under Texas law for relying upon, and asking a court to consider, extrinsic evidence in the pollution exclusion context. Because the decisions are not completely in line with all precedent on the extrinsic evidence issue, however, we have set out a somewhat extensive discussion of that precedent in the next subsection. A very recent case, *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir. 2004), is directly contrary to the *Vic Manufacturing* and *Primrose* decisions and merits particular attention, for the reasons explained below.

2. Other Texas Precedent on the Use of Extrinsic Evidence

a. The Basic Principles

It is well established in Texas that an insurer's duty to defend must be determined under the "eight corners" rule – that is, by comparing the four corners of the policy to the four corners of the underlying petition. As recently stated by the Texas Supreme Court:

> An insurer's duty to defend is determined solely by the allegations in the pleadings and the language of the insurance policy. This is the "eight corners" or "complaint allegation rule." If a petition does not allege facts within the scope of coverage, an insurer is not

> legally required to defend a suit against its insured. But we resolve all doubts regarding the duty to defend in favor of the duty.

King v. Dallas Fire Ins. Co., 85 S.W.3d 185, 187 (Tex. 2002). Thus, the duty to defend arises only when the facts alleged in the complaint, if taken as true, would potentially state a cause of action falling within the terms of the policy. *Canutillo Indep. Sch. Dist. v. Nat'l Union Fire Ins. Co.*, 99 F.3d 695, 701 (5th Cir. 1996). The insured bears the initial burden of establishing that a claim against it is potentially within the policy's coverage. *Id.* The insurer is obligated to defend the insured, provided that the petition or complaint alleges at least one cause of action potentially within the policy's coverage. *Id.*

The focus of the "eight corners" inquiry is on the alleged facts, not on the asserted legal theories. *St. Paul Fire & Marine Ins. Co. v. Green Tree Fin. Corp.*, 249 F.3d 389, 392 (5th Cir. 2001). If the petition only alleges facts excluded by the policy, the insurer is not required to defend. *Fidelity & Guar. Ins. Underwriters, Inc. v. McManus*, 633 S.W.2d 787, 788 (Tex. 1982). Facts ascertained before suit, developed in the process of litigation, or determined by the ultimate outcome of the suit do not affect the duty to defend. *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 829 (Tex. 1997).

How strict is the rule? Are there any exceptions by which an insurer or insured may rely upon extrinsic evidence (evidence outside the policy and underlying pleading) to establish or to decline a duty to defend?

As demonstrated below, the rule is strict, but a number of exceptions have been recognized.

b. The Texas Supreme Court

While the Texas Supreme Court has yet to address the issue of whether extrinsic evidence, under certain circumstances, may be considered when determining a duty to defend, it is nonetheless helpful to review certain decisions which illustrate how the eight corners rule has been applied. The pivotal Texas Supreme Court case which established the eight corners rule is *Heyden Newport Chem. Co. v. Southern Gen'l Ins. Co.*, 387 S.W.2d 22 (Tex. 1965). *Heyden* involved an auto policy issued to a truck fleet owner, Raymond Pickering. Pickering's policy extended coverage to anyone legally responsible for the use of the covered vehicle. Pickering's employee, Marks, was involved in a fatal accident while driving on behalf of Heyden Newport. Marks, Pickering and Heyden Newport were all named as defendants. Newport and its insurer contended that Heyden Newport was covered under Pickering's policy as an additional insured.

The underlying petition alleged that at the time of the accident, Marks and Pickering were acting as the agents of Heyden Newport such that Heyden Newport would have been vicariously responsible for the survivors' claims. Pickering's insurer defended Marks and Pickering, but denied coverage for Heyden Newport. It offered proof that Pickering was in fact an independent contractor rather than the corporation's agent and thus would not be "legally responsible for the use of the covered vehicle" for coverage purposes.

The Texas Supreme Court held that the corporation was entitled to coverage and adopted what is now known as the "eight corners rule." The Court declared:

> We think that in determining the duty of a liability insurance company to defend a lawsuit, the allegations of the complaint should be considered in the light of the policy provisions without reference to the truth or falsity of such allegations and without reference to what the parties know or believe the true facts to be, and without reference to a legal determination thereof.

387 S.W.2d at 24. It should be noted, however, that the extrinsic evidence was inconsistent with the factual allegations.

In *National Union Fire Insurance Co. v. Merchants Fast Motor Lines*, the Texas Supreme Court held that there was no duty to defend a drive-by shooting claim under an automobile policy because the allegations against the insured did not state that the injury was caused by the use of a vehicle.[4] The court refused "to look outside the pleadings, or imagine factual scenarios which might trigger coverage."

Similarly, in *Trinity Universal Ins. Co. v. Cowan*, the court would not expand allegations of mental anguish to encompass the resulting physical manifestations when no such damages were specifically claimed.[5] The court refused to "read facts into pleadings" to determine the duty to defend. Corresponding with these dictates, the Texas Supreme Court clearly stated that an insurer has no obligation to investigate third party claims to determine its defense obligations. "[A]n insurer is entitled to rely solely on the factual allegations contained in the petition in connection with the terms of the policy to determine whether it has a duty to defend."[6]

The Texas Supreme Court has not expressly addressed whether there is an exception to the eight corners rule. *Westport Ins. Corp. v. Atchley, Russell, Waldrop & Hlavinka, L.L.P.*, 267 F. Supp. 2d 601, 612-13 (E.D. Tex. 2003). To determine whether there are, in fact, any exceptions, therefore, we must turn to the decisions of the Texas courts of appeals and federal courts interpreting Texas law.

c. The Texas Courts Of Appeals

—*Wade*: The Broad Approach

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[4] 939 S.W.2d 139, 142 (Tex. 1997). *See also Clemons v. State Farm Fire & Cas. Co.*, 879 S.W.2d 385, 393 (Tex. App.—Houston [14th Dist.] 1994, no writ) ("Simplistically stated, to implicate the policy provision concerning damages for bodily injury or property and thereby the duty to defend, the petition must allege bodily injury or property damage. Here, it does not, and we cannot judicially read these elements of damage into the petition.").

[5] 945 S.W.2d 819, 825 (Tex. 1997).

[6] *Id.* at 829.

In *Wade*, the insurer brought a declaratory judgment action on a policy that covered boat accidents arising from specific uses.[7] The court recognized that the eight corners rule generally restricts the court to consideration of the allegations in the claimant's pleadings and the insurance policy. The court, however, also noted: "The problem here is that by reading the underlying petition broadly, in favor of the insured, it is impossible to know how the boat covered by the policy was used when it left the [the dock]." *Id.* at 451. Thus, the eight corners rule impeded the court's inquiry into important coverage facts. In the face of that impediment, the court stated that:

> the insurer is not foreclosed from litigating the application of an exclusion by using evidence and facts outside the pleadings in the underlying wrongful death suit ... It makes no sense to us, in light of these holdings, to say that extrinsic evidence should not be admitted to show that an instrumentality (boat) was being used for a purpose explicitly excluded from coverage, particularly when doing so does not question the truth or falsity of any facts alleged in the underlying petition filed against the insured.

Id. at 451, 453. Thus, the court concluded that it could consider extrinsic evidence relevant to coverage, so long as the evidence did not overlap or contradict the factual allegations in the underlying suit against the insured.

Wade relied on three prior state court cases:

- *International Service Ins. Co. v. Boll*, 392 S.W.2d 158 (Tex. Civ. App.--Houston [1st Dist.] 1965, writ ref'd n.r.e.). In *Boll*, the insurance policy excluded coverage for accidents involving a certain named person. The underlying petition did not allege that the accident was caused by the excluded person, but only identified the driver as the "son" of the policyholder. After the conclusion of the underlying suit, the parties stipulated that the insured's only son was the same as the named person excluded from coverage. Thus, the court considered extrinsic evidence of the identity of the son, by stipulation, to conclude that no coverage existed and that no duty to defend or indemnify arose.

- *Cook v. Ohio Casualty Ins. Co.*, 418 S.W.2d 712 (Tex. Civ. App.--Texarkana 1967, no writ). In *Cook*, the court examined *Boll* and *Heyden* and opined that the Texas Supreme Court would distinguish between extrinsic evidence that went to the merits of the underlying claim and evidence that went only to coverage facts under the policy. Because the facts before it were nearly identical to those in *Boll*, the court permitted the introduction of extrinsic evidence. The policy excluded from coverage any liability the insured incurred while driving her mother's automobile, and the fact that the insured wife was driving her mother's car at the time of the collision appeared by stipulation on file and in the affidavit attached to the insurance company's motion for summary judgment.

- *Gonzales v. American States Ins. Co.*, 628 S.W.2d 184, 186 (Tex. App.--Corpus Christi 1982, no writ). In *Gonzales*, the insured was sued after a child was injured by a

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[7] *State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448, 452-53 (Tex. App.—Corpus Christi 1992, writ denied).

malfunctioning ice auger that the insured had welded at an ice company. The insurer sought to avoid a defense obligation by introducing extrinsic evidence that the insured did not own the machine and that, therefore, the injury fell within the completed operations hazard exclusion. The appellate court *rejected use of the evidence*, however, after discussing both *Boll* and *Cook* and the distinctions those cases draw between "merits facts" and "coverage facts." The petition's allegations that the insured owned the piece of equipment that injured the plaintiff, though not true, stated a cause of action not within the completed operations hazard exception. The evidence showing the insured did not own the equipment could not be used in the determination because it went to the issue of liability rather than coverage. The *Gonzales* court posited the following rule:

> Where the insurance company refuses to defend its insured on the ground that the insured is not liable to the claimant, the allegations in the claimant's petition control, and facts extrinsic to those alleged in the petition may not be used to controvert those allegations. **But where the basis for the refusal to defend is that the events giving rise to the suit are outside the coverage of the insurance policy, facts extrinsic to the claimant's petition may be used to determine whether the duty to defend exists.**

Gonzales, 628 S.W.2d at 187 (emphasis added). Thus, the *Gonzales* court would not examine any extrinsic evidence that tended to contradict an allegation made in the petition, though it would have examined "coverage only" facts.

—*TriCoastal*: A More Narrow Approach

In *Tri-Coastal Contrs., Inc. v. Hartford Underwriters Ins. Co.*, 981 S.W.2d 861 (Tex. App.—Houston [1st Dist.] 1998, pet. denied), the insured employer was sued by an employee for a work-related injury. The employee alleged that the employer was negligent and made no mention of worker's compensation benefits. Hartford Underwriters, the insured's workers' compensation and employers' liability insurer, defended under a reservation of rights. After the employee's suit was settled, Hartford sued the insured for declaratory relief and claimed that it had no duty to defend the insured because it had paid workers' compensation benefits to the employee and the employers' liability policy excluded all workers' compensation-related liabilities.

Attached to Hartford's motion for summary judgment on this issue were the policy, copies of checks showing payment of compensation benefits and other documents. The trial court granted the motion. On appeal, the same court that issued the 1965 *Boll* opinion upon which *Wade* was based (the Houston First District Court of Appeals) reversed and held that, under the eight corners rule, the trial court erred by considering extrinsic evidence in determining Hartford's duty to defend because it went directly to the issue of the insured's liability.

In reaching this result, the court addressed the above-discussed *Cook*, *Boll* and *Wade* cases as follows:

> Generally, extrinsic evidence is not permitted when determining whether an insurer has a duty to defend. In Texas, extrinsic evidence is permitted to show no duty to defend only

> in very limited circumstances, for example where the evidence is used to disprove the ***fundamentals of insurance coverage, such as whether the person sued is excluded from the policy, whether a policy contract exists, or whether the property in question is insured under the policy***. *See, e.g., Cook v. Ohio Cas. Ins. Co.*, 418 S.W.2d 712, 715-16 (Tex. App.--Texarkana 1967, no writ) (extrinsic evidence allowed to show automobile involved in accident was excluded from coverage); *International Serv. Ins. Co. v. Boll*, 392 S.W.2d 158, 161 (Tex. App.--Houston [1st Dist.] 1965, writ ref'd n.r.e.) (extrinsic evidence allowed to show person involved in accident was excluded from policy); *see also State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448, 454 (Tex. App.--Corpus Christi 1992, writ denied) (concurring opinion discussing use of extrinsic evidence). Here, the evidence was not sought to show the person or entity sued, Tri-Coastal, was excluded from coverage, but to show the person suing, Antwine, was excluded from coverage.
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> The original purpose of the eight-corners rule was to preclude an insurance company from refusing to defend an insured based on the lack of merit of the plaintiff's case. Because a liability policy is a contract under which an insurance company agrees to assume both the defense of the suit and the liability if the insured was found responsible, the eight corners rule prevents the insurance company from refusing to defend based on the merits of the suit.

Tri-Coastal, 981 S.W.2d at 863-64 (emphasis added; some citations omitted).

—Other Texas Court of Appeals Decisions

In addition to the foregoing cases, other Texas state court decisions have reached divergent, but similar, results:

Extrinsic Evidence Not Allowed:

- The Fort Worth Court of Appeals recently held that a trial court may not even consider a date-related ***stipulation*** of the insurer and insured, because the stipulation is outside of the policy and pleadings. *See Fielder Road Baptist Church v. GuideOne Elite Insurance*, No. 2 02 231 CV, 2004 Tex. App. LEXIS 4557 (Tex. App.—Fort Worth, May 20, 2004, n.p.h.) (where plaintiff alleged abuse from 1992 to 1994 at the hands of an associate youth minister, and the church's policy was in force from 1993 to 1994, it was error for the trial court to consider the parties' stipulation that the minister's employment terminated before the policy's inception). Although the Fort Worth court accepted the "fundamental coverage issues" exception in principle, the court found that the exception did not apply in this case because the date issue had some bearing on the insured's liability and the stipulation was at variance with the underlying allegations. *See id.*

- In *Reser v. State Farm Fire & Cas. Co.*, 981 S.W.2d 260 (Tex. App.—San Antonio, 1998, no writ), a generally non-covered claim included a defamation

claim, and the insurer provided a defense subject to a reservation of rights. When the petition was amended to delete the defamation allegations and related request for damages, the insurer withdrew the defense. The court rejected the insured's argument that by virtue of the original petition, State Farm knew of facts that could have been alleged and which would have provided coverage. The live or most current pleading controlled, the court ruled.

- In *Consolidated Underwriters v. Loyd W. Richardson Const. Corp.*, 444 S.W.2d 781 (Tex. Civ. App.—Beaumont 1969, writ ref'd n.r.e.), the insured's CGL policy excluded "completed operations" coverage. Following Hurricane Carla, the insured built a temporary road to allow Tenneco employees to reach the plant. Shortly after the first phase of the roadwork had been completed, an accident occurred on the road. *Id.* at 783. While the plaintiff's original and first amended petitions were silent on the status of the construction, the second amended petition stated that the insured's work had been completed and accepted by Tenneco prior to the accident. At that time, the insurer withdrew its defense and cited the completed operations exclusion. *Id.* The insured, relying upon *Boll* and *Cook*, sought to introduce oral evidence that the agreement between itself and Tenneco called for further work on the roadway. The court of appeals refused, however, and held that the pleadings alone controlled the duty to defend.

Extrinsic Evidence Allowed:

- In *Texas Medical Liability Trust v. Zurich Ins. Co.*, 945 S.W.2d 839, 842, n. 5 (Tex. App.—Austin 1997, writ denied), breast implant patients sued the manufacturer and a number of physicians for injuries arising out of the implants. The physicians sought additional insured status under the manufacturer's insurance policies through an omnibus additional insured clause that extended coverage to any "vendors" selling the implants. Although the court expressly rejected the notion of ever looking beyond the "eight corners," the court did, in fact, look beyond the policy and pleading it its opinion. Specifically, it noted that "the [underlying] petition is silent as to whether [the breast implant] sales constituted the regular course of the physicians' business[,]" and then consulted summary judgment proof (apparently from the coverage case) to confirm that the doctors were not "vendors" but were simply in the general business of selling medical services.

d. The Fifth Circuit

Historically, the Fifth Circuit, applying Texas law, has allowed extrinsic evidence to be considered. A recent decision by one panel of the court, however, may mark a departure from what appeared to be a trend. *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir. 2004).

In *Northfield*, the insurer appealed from a declaratory judgment which established that the insurer had a duty to defend a nanny service and its owners in an underlying tort suit. The

claimant parents' baby was fatally injured while under the care of one of the insured's nannies, and the nanny was subsequently found guilty of first-degree felony injury to a child. Despite the conviction, the parents' amended complaint in the tort action stated a cause of action for negligence.

The insurer argued that it had no duty to defend because the policy contained exclusions relating to criminal acts and physical abuse. The Fifth Circuit affirmed and found that that the district court properly applied the eight corners rule to determine that the exclusions did not apply to a negligence action. Under that rule, extrinsic evidence, even in the form of a criminal conviction, was not admissible to determine whether the baby's death resulted from a criminal act or physical abuse.

In reaching that decision, the court concluded that:

> [T]his Court makes its *Erie* guess that the current Texas Supreme Court would not recognize any exception to the strict eight corners rule. That is, if the four corners of the petition allege facts stating a cause of action which potentially falls within the four corners of the policy's scope of coverage, resolving all doubts in favor of the insured, the insurer has a duty to defend. If all the facts alleged in the underlying petition fall outside the scope of coverage, then there is no duty to defend.

Northfield, 363 F.3d at 529. This three-judge panel of the the Fifth Circuit acknowledged that some Texas courts of appeals have accepted the "fundamental coverage issues" exception, but it rejected even this limited exception because it has not been adopted by the Texas Supreme Court. The court noted however, that

> in the unlikely situation that the Texas Supreme Court were to recognize an exception to the strict eight corners rule, we conclude any exception would only apply in very limited circumstances: when it is initially impossible to discern whether coverage is potentially implicated and when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case.

Id. at 531. We must point out that the decision of the panel in *Northfield* is contrary to several prior Fifth Circuit decisions by other panels. These decisions are still good law and are discussed below:

- In *Harken Expl'n Co. v. Sphere Drake Ins. PLC*, 261 F.3d 466 (5th Cir. 2001), the Fifth Circuit allowed the insured to present extrinsic evidence to show that property damage may have occurred during a particular insurer's policy period. The petition alleged property damage of an ongoing, continuous nature and stated that "releases and discharges have occurred at least 53 times, including occasions after . . . February 1997." 261 F.3d at 476. Sphere Drake's policy expired on October 1, 1996. When Sphere Drake sought declaratory relief on the matter, the Fifth Circuit allowed the insureds to introduce the mineral lease, showing that their involvement dated back to December 15, 1995. This was sufficient to compel Sphere Drake to defend the underlying case. *See also Essex Ins. Co. v.*

Redtail Products, Inc., 1998 WL 812394, at *3 (N.D. Tex. 1998) (where underlying complaint stated that trademark violations occurred "recently," the district court held that since the complaint did not contain facts sufficient to enable the court to determine whether the trademark violations occurred during the policy period, "the [eight corners] rule is inapplicable and the court will consider extrinsic evidence to determine whether Essex had a duty to defend or indemnify Redtail.")

- *John Deere Insurance Co. v. Truckin' U.S.A.*, 122 F.3d 270, 272-73 (5th Cir. 1997). In *John Deere*, the Fifth Circuit determined that extrinsic evidence could be considered in an insurance dispute where the underlying petition only alleged that the tractor trailer rig involved in an accident had been furnished to the defendants or that defendants had a working relationship with the insured trucking company. There, because the facts alleged were insufficient, even if taken as true, to state a cause of action under the policy, extrinsic evidence was allowed to show whether the rig was a "covered auto" such that insurer had a duty to defend. *Id.*

- *Western Heritage Ins. Co. v. River Entm't*, 998 F.2d 311, 313 (5th Cir. 1993). In *Western Heritage*, the Fifth Circuit determined that extrinsic evidence could be used in an insurance dispute where the underlying amended petition did not allege or provide any factual explanation for how the restaurant patron involved had arrived at such an impaired state that he could not operate a vehicle. 998 F.2d at 313-15. There, because the facts alleged were not specific enough, even interpreted in the light most favorable to the insured, to possibly bring the claim within the negligence coverage of the policy, which specifically excluded damages stemming from the sale of alcoholic beverages to an intoxicated person, extrinsic evidence was allowed to determine the insured's duty to defend. *Id.*

- In *Gulf Chem. & Metallurgical Corp. v. Assoc. Metals & Minerals Corp.*, 1 F.3d 365 (5th Cir. 1993), roughly 5000 plaintiffs sued some 2000 defendants, including Gulf Chemical, in state court, alleging they had been exposed to various toxic chemicals from 1946 to 1990. The plaintiffs' case against Gulf Chemical involved exposure to molyoxide, which Gulf had handled and shipped in the mid- to late-1980s. In the course of the litigation, it was learned that Gulf had never made shipments of molyoxide before the inception of the policy issued by one of the insurers, International Surplus Lines Insurance Company (ISLIC), and ISLIC sought to disclaim coverage on that basis. The district court granted ISLIC's motion for summary judgment, but the Fifth Circuit reversed and held that the underlying petition's allegations of injurious exposure and damage from 1946 to 1990 controlled the resolution of the issue. 1 F.3d at 370-71. Acknowledging that courts occasionally look outside the pleadings to determine coverage issues, *id.* at 371, the Court suggested that if the insurer wanted to end its involvement with the underlying toxic tort case, it could file a motion for partial summary judgment on the molyoxide shipment issue in the underlying lawsuit. *Id.* Obviously, the motion would be based upon extrinsic evidence.

The *Northfield* decision, therefore, must be read in light of the prior Fifth Circuit cases and the Texas courts of appeals decisions that have allowed extrinsic evidence. The panel in *Northfield*, in this author's opinion, should have certified the question to the Texas Supreme Court given the conflict in authority.

e. Federal Trial Courts

The federal trial courts in Texas have reached a variety of conclusions:

Extrinsic Evidence Not Allowed:

- In *Westport Ins. Corp. v. Atchley, Russell, Waldrop & Hlavinka, L.L.P.*, 267 F. Supp. 2d 601 (E.D. Tex. 2003), the underlying suit was a legal malpractice claim against an insured law firm. The malpractice carrier asserted an exclusion that would preclude coverage (1) when, before the policy period begins, an attorney had subjective knowledge that a claim would be made against him; and (2) when the attorney was engaged in willful blindness by ignoring the high probability that his actions would result in a claim being filed against him. On cross-motions for summary judgment, the parties "submitted extensive stipulations about various facts. These facts do not necessarily originate from the claimant's petition filed against the insured in the state court. In some instances, these stipulations, while not necessarily inconsistent with the claimant's state court petition, go well beyond the claimant's allegations in terms of factual specificity." *Westport*, 267 F. Supp. 2d at 611-12.

  Faced with these stipulations, the court first had to consider whether they were admissible in light of the eight corners rule. The court concluded that the stipulations were not admissible. None of the stipulations pertained to a "fundamental coverage issue, such as the existence of the policy or whether a named insured or specified property has been identified as being specifically excluded from coverage." *Id.* at 622. The court, therefore, confined itself to the insurance policy and underlying pleadings. The court concluded that factual allegations in the state court petition against the attorneys did not trigger the exclusion's subjective prong. Further, nothing in the state court allegations suggested that any of the alleged wrongs were so blatant that any lawyer would expect to see a claim because of them. Although the state court proceedings might develop the actual facts in such a way that the exclusion might later be triggered, only the facts alleged were relevant in this action.

Extrinsic Evidence Allowed:

- In *Southwest Tank*,[8] the court utilized extrinsic evidence in determining an insurer's duty to defend its insured under a CGL policy. Southwest Tank and Treater, the insured, was hired to install heating elements in a tank owned by Trinity Asphalt. During the course of performing the work, the tank caught fire and exploded, thereby necessitating replacement. Trinity Asphalt sued Southwest Tank, which in turn demanded that Mid-Century provide a defense and indemnity under its CGL policy. Mid-Century declined and cited to the faulty workmanship exclusions in the policy.

  The court determined that the use of extrinsic evidence was necessary to determine if the faulty workmanship exclusion applied, based upon the lack of factual allegations in Trinity Asphalt's pleadings. The court's determination was largely based upon the fact that Mid-Century sought to introduce evidence that the events giving rise to the suit were outside of the scope of coverage. Trinity Asphalt's pleadings failed to describe what occurred and, instead, provided only conclusory allegations that Trinity Asphalt's damages were proximately caused by Southwest Tank and Treater's negligence. After considering evidence (deposition testimony of the president of Southwest Tank) that Southwest Tank and Treater was hired to perform work on the tank, and was actually performing work on the tank when the explosion occurred, the court held that the faulty workmanship exclusion applied.

- In *Acceptance Ins. Co. v. Hood*, 895 F. Supp. 131 (E.D. Tex. 1995), the district court admitted extrinsic evidence which proved that a decedent was the insured's employee, and thereby excluded from coverage. The insured owned two businesses at the same premises, a plumbing business, covered by the subject insurance policy, and an exotic animals kennel, not covered by the policy. A plumbing service employee, Chopen, was fatally mauled by a bengal tiger. *Id.* at 132. The survivors alleged that the accident arose out of Hood's plumbing business, arguably triggering the policy, but omitted the fact that Chopen was an employee of the plumbing business, which would have triggered the policy's employee exclusion. The court allowed the insurer to supplement the petition with evidence that Chopen was an employee. *Id.* at 134, fn. 1.

- In *Ohio Cas. Ins. Co. v. Cooper Machinery Corp.*, 817 F. Supp. 45 (N.D. Tex. 1993), the district court allowed the insurer to contradict the claimant's allegations and prove by extrinsic evidence it had no duty to defend. The underlying plaintiff was injured at his work site by a steamroller sold by the insured heavy equipment retailer, Cooper, to the plaintiff's employer. The policy excluded coverage for injuries included within the products liability/completed operations hazard. In an amended petition, the plaintiff alleged that Cooper had

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[8] *Southwest Tank and Treater Manufacturing Company v. Mid-Continent Casualty Company*, No. 6:01-CV-542, 2003 WL 223445 (E.D. Tex. Feb. 4, 2003).

"failed to properly complete and finish the manufacturing of the roller in question." *Id.* at 47. In a phone conference with the Court, however, Cooper's attorney practically conceded that this allegation was false, that Cooper had added no manufacturing services to the roller and merely served as a retail intermediary. *Id.* at 48. On these facts, the Court held for the insurer:

> [Cooper's attorneys] apparently have the misplaced notion that a false allegation in the state court pleading of [plaintiff] can impose on [the insurer] a duty to defend Cooper. . .
>
> * * *
>
> Moreover, Cooper and [the underlying plaintiff] are mistaken in thinking that the claimant can, in effect, create coverage by a false allegation of a coverage fact in the state court pleading. While an insurance company cannot avoid the policy defense obligation on the ground that extrinsic facts establish that its insured is not liable to the claimant, it can avoid the defense obligation if the extrinsic facts show that the alleged facts pertaining to coverage are false and that under the true facts there is no coverage under the policy...

817 F. Supp. at 48.

- In *McLaren v. Imperial Cas. & Ind. Co.*, 767 F. Supp. 1364 (N.D. Tex. 1991), *aff'd*, 968 F.2d 17 (5th Cir. 1992), the underlying plaintiff alleged that she was sexually assaulted by a police officer within the scope of the officer's employment. *Id.* at 1373-74. The court determined that even if it were to apply the eight corners rule, it would favor the insurer. *Id.* at 1374. But citing to the discussion in *Gonzales* (see discussion of state court decisions, above), it added:

> Moreover, there appears to be a more general rule that the true facts always can be used to establish non-existence of a defense obligation, no matter what the plaintiffs might allege in her damage suit complaint. . .
>
> * * *
>
> Under this rule, even if McLaren's damage suit pleading could be read to allege facts that, if true, would cause coverage to exist, Imperial nevertheless would not have a duty to defend the suit because the facts would be false. . .

767 F. Supp. at 1374.

- In *Blue Ridge Ins. Co. v. Hanover Ins. Co.*, 748 F. Supp. 470 (N.D. Tex. 1990), the question was whether the driver of a company vehicle involved in an accident was authorized to drive the truck by the company, as alleged in the underlying lawsuit. As a factual matter, the driver (the son of an employee) was not authorized to drive the truck. The court, denying coverage based on this extrinsic fact, said the *Gonzales* rationale is especially pertinent when the basic coverage question is whether or not the defendant in the underlying suit is even an insured. The Court added "The status of 'insured' is to be determined by the true facts, not

false, fraudulent or otherwise incorrect facts that might be alleged by a personal injury claimant." 748 F. Supp. at 473.

3. Some Practice Pointers Regarding the Use of Extrinsic Evidence

What can a claims representative fairly do when considering the use of extrinsic evidence?

1. If the allegations in the most recent petition would support a denial without reliance upon extrinsic evidence, the representative should omit any reference to that proof in the denial letter; and

2. Given the significant authority cited above, the representative should feel comfortable relying upon extrinsic evidence if the proof: (a) merely supplements or clarifies facts alleged; (b) does not contradict any factual allegations; and (c) does not go to the ultimate issue of the insured's liability.

If the facts relied upon are also admitted by the insured, then courts will be less likely to exclude the evidence.

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