# The Construction Report

Volume 8 Issue 1 January 2008

**Published periodically by Quilling, Selander, Cummiskey & Lownds, P.C., 2001 Bryan Street, Suite 1800, Dallas, Texas 75201**
**Brian W. Erikson, Editor, (214) 880-1844; Fax (214) 871-2111**

## *Contract Gotchas* You Gotta Know

It pays to recognize contract terms that can cause major harm. This article is the first in a series that highlight various *Contract Gotchas*, deal killers, and methods for coping with the *Gotchas*.

**-Indemnity**

Probably the most troubling *Contract Gotcha* is that requiring indemnity. Here's why. A valid indemnity provision requires one party such as a contractor or design professional (the "Indemnitor") to reimburse or hold harmless another such as the project owner even for those damages caused exclusively by the owner's own negligence. This obligation holds even where the Indemnitor is not negligent or does not in any way contribute to the problem. (To determine if an indemnity clause is legally binding, see the article on page 4.)

***If you have agreed to indemnify another, you may also have agree to pay punitive damages.***

Even worse, if indemnity is due, the Indemnitor may also be liable for the damages caused by the owner's gross negligence. In theory, a grossly negligent party may be assessed punitive damages large enough to teach a lesson and convince the party to avoid such conduct in the future. If indemnity is due, the owner's punitive debt may have to be shouldered by the Indemnitor. Insurance can cover an indemnity obligation. But, public policy may prohibit insurance from covering punitive damages. The indemnity obligation can be so substantial that bankrupts the Indemnitor even though it has no actual fault. Simply put, agreeing to an indemnity provision can be a bet the company proposition, each and every time.

If there has to be indemnity, perhaps the best way of coping is to buy insurance, and limit the indemnity obligation to the amount of insurance proceeds. That way, the Indemnitor has no independent liability, and simply buys the amount of insurance the owner requires.

Alternatively, the Indemnitor can limit the amount of indemnity to a set amount (say, the amount of payment), or to a percentage of fault.

**-No Damages for Delay**

An owner can use a no damages for delay clause to shield itself from liability for delaying a project's progress. Ordinarily, the owner is responsible for delays the owner causes to the contractor. For exam-

*(Continued as "Gotchas" on page 2)*

## Lawyer Quips and Quotes

NASA was interviewing professionals to be sent to Mars. Only one could go -- and couldn't return to Earth.

The first applicant, an engineer, was asked how much he wanted to be paid for going. "A million dollars," he answered, "because I want to donate it to M.I.T."

The next applicant, a doctor, was asked the same question. He asked for $2 million. "I want to give a million to my family," he explained, "and leave the other million for the advancement of medical research."

The last applicant was a lawyer. When asked how much money he wanted, he whispered in the interviewer's ear, "Three million dollars."

"Why so much more than the others?" asked the interviewer.

The lawyer replied, "If you give me $3 million, I'll give you $1 million, I'll keep $1 million, and we'll send the engineer to Mars."

**

I'm a great believer in luck, and I find the harder I work the more I have of it.
- Thomas Jefferson (1743-1826)

My formula for success is rise early, work late, and strike oil.

-J. Paul Getty (1892—1976)

If a million people say a foolish thing, it is still a foolish thing.
-Anatole France [Jacques Anatole Thibault] (1844—1924)

TCR

*(Continued from "Gotchas" on page 1)*

ple, the owner may be responsible for obtaining rights of way on a project. If the owner does not obtain the rights of way in a timely manner and delays the work, the owner can be liable for the contractor's extra costs.

The cases that follow show the significance of a No Damages for Delay clause.

In *Anderson Development Corp. v. Coastal States Gathering Co.*, 543 S.W.2d 402 (Tex.Civ.App. -- Houston [14th Dist.] 1976, writ ref'd n.r.e.), the owner had to obtain the rights of way for the work. The parties had planned to do the work in the dry summer months. When the owner failed to obtain the rights of way before the summer, the contractor had to perform the work in the fall while dodging rain storms. As a result, the work was performed sporadically as weather permitted and cost significantly more. When the contractor did not complete work until three months after the scheduled completion date, it successfully sued to recover its extra costs.

In *Board of Regents of the University of Texas v. S&G Construction Co.*, 529 S.W.2d 90 (Tex.Civ.App. -- Austin 1975, writ ref'd n.r.e.), the owner failed to provide proper plans and specifications. The work was delayed while the job was redesigned on a daily basis. The contractor incurred about $900,000 in extra costs resulting from the massive number of changes. When the contractor sued to recover the extra money, the court held that the owner had caused the delays and increased the costs, and should pay for them.

***The Obligation of Continuing Performance requires the contractor to continue construction during payment disputes.***

With a no damages for delay clause, the owner can disclaim responsibility for the contractor's extra costs arising from project delays. Texas courts have upheld the no damages for delay disclaimer.

In *City of Houston v. RF Ball Construction Co.*, 570 S.W.2d 75 (Tex.Civ.App. -- Houston [14th Dist.] 1978, writ ref'd n.r.e.), the contractor received several hundred change orders and almost 900 design clarifications radically altering the project design documents. The contractor sustained an extra $3 million in cost not including the direct costs of performing all the extra work. The contractor sued to recover the indirect costs of delay, disruption, general hindrance, and inefficiency.

The court held that although the parties had not contemplated the large number of changes when the contract was signed, the contract's no damages for delay clause barred recovery for extra indirect costs for changes and modifications.

There are exceptions to the no damages for delay clause. In general, a no damages for delay clause will not be enforced if the delays were not contemplated when the contract was signed or if the delays were caused by the owner's active interference, bad faith, or intentional misconduct, or if the owner abandons the contract. Finally, if the owner materially misrepresents site conditions or conceals material site conditions information, the owner may be liable for delays the contractor sustains.

## The Editor's Corner

*The Construction Report is published periodically by Quilling, Selander, Cummiskey & Lownds, P.C., to highlight construction matters of interest to at least the Editor, Brian W. Erikson. The information we provide is a community service and is not intended to displace the legal judgment of real (expensive) attorneys. We invite your comments. Write us c/o* ***Brian W. Erikson****, 2001 Bryan Street, Suite 1800, Dallas, Texas 75201. Call us at* ***(214) 880-1844****.*

TCR

When asserting delay-type claims, the contractor needs to build them with specific costs, and omit the term "delay". Maintaining appropriate cost accounting codes is important.

**-Obligation of Continuing Performance**

The Obligation of Continuing Performance requires a contractor to continue project construction while the parties negotiate or otherwise resolve a dispute. The dispute may involve something as basic as whether the owner has to pay the contractor for certain work on the project. With this clause in place, the contractor would have to continue construction without being paid. If the contractor decides to stop construction pending resolution of the dispute, the work stoppage could be deemed a breach of contract and subject the contractor to liability and damages.

**-Responsibility for Defects in Contract Documents**

In the design, bid, build scenario (typical of most government projects), the owner retains design consultants to prepare the project's design. Prospective contractors submit proposals to construct the design. The design may or may not contain errors. The owner may or may not know that the design contains errors. By contract, the owner may validly require the

*(Continued as "Gotchas" on page 3)*

*(Continued from "Gotchas" on page 2)*
contractor to assume the responsibility of any design defects, even though the contractor had no involvement in the design process (unlike with a design-build contract), and had no opportunity to analyze the design intent. Absent fraud, the courts will generally enforce such terms as part of the parties' agreement.

**-Responsibility for Changes in Regulations**

The owner may also attempt to require the contractor to assume the responsibility of any changes in regulations or regulatory requirements. It is difficult for either party to foretell possible changes. Sometimes the parties suspect that regulatory changes are being considered. It is difficult to assess the cost of possible changes before they occur. This provision creates ambiguity, and may be unenforceable on that basis. Still, many courts will enforce the term as part of the parties agreement, and hold that the contractor agreed to assume that financial risk.

**-Change Order Pricing**

Contracts often define how the contractor will be paid for change orders. The contract may dictate that the contractor will be paid for only its direct costs and will not be paid for profit or overhead for change order work. The provision may be abused if an owner doubles or triples the amount of contract work.

The harsh effect of this provision may be limited by the cardinal change doctrine, which proscribes fundamental changes, or other contract provisions that limit changes to no more than a certain percentage .

**-To be continued . . .**

The next issue of The Construction Report will focus on such *Contract Gotchas* as the termination for convenience, decision maker, and decision is final provisions, among others.

TCR

*(Continued from "Determine" on page 4)*
writes the indemnity provision in clear black and white language, the contractor will not have to indemnify the owner for the owner's own negligence.

The standard American Institute of Architects contract language like that in the AIA A201 General Conditions does not satisfy the *express negligence doctrine*, since it does not even mention the owner's negligence.

In *Atlantic Richfield Co. v. Petroleum Personnel, Inc.*, 768 S.W.2d 724 (Tex. 1989), the court validated a provision that required indemnity for "any negligent act or omission of the owner, its officers, agents or employees."

In *Dresser Industries v. Page Petroleum Co.*, 853 S.W.2d 505

(Tex. 1993), the court stressed that an indemnity agreement must be conspicuous enough to provide "fair notice" of its term. To provide "fair notice," an indemnity provision must be apparent to a reasonable person. A notation on the face of the contract which draws attention to the provision, such as capital letters or contrasting type or color is sufficient. The indemnity provision cannot be hidden within unrelated language or terms.

In *Fisk Electric Co. v. Constructors & Associates*, 888 S.W.2d 813 (Tex. 1994), the court held that if an indemnity provision does not initially satisfy the *express negligence doctrine*, an indemnitor has no duty to indemnify another for their attorney's fees even if the other was later found not to be negligent.

The Texas Civil Practice & Remedies Code §130.002 invalidates a provision which attempts to have a contractor indemnify an architect or engineer for liability and damage for personal injury, property damage, and expenses arising from the design professional's negligence in preparing plans or specifications or in contract administration.

Texas Government Code §2252.902 invalidates indemnity provisions on state public work, but allows indemnity on construction contracts where liability is caused by the sole, joint or concurrent negligence of the indemnitee, and arises from bodily injury or death of an employee of the Indemnitor or its subcontractors. This provision does not affect insurance coverage, and may not be waived by contract.

Texas Government Code §2254.0031 allows a state governmental entity to require indemnity for claims that the contractor was negligent. The section prohibits the State from requiring that the contractor indemnify the State for the State's own negligence.

If the owner has required the contractor to indemnify the owner for the owner's own negligence, the contractor should secure sufficient liability insurance to cover the risk. If the contractor cannot obtain such insurance, the contractor should seriously consider qualifying its bid or not bidding at all. A Texas court has held that an agreement to cover a party's negligence also covers the party's gross negligence, which could result in punitive damage award in millions of dollars.

**

Opportunity is missed by most because it is dressed in overalls and looks like work."

--Thomas Alva Edison (1847-1931)

TCR

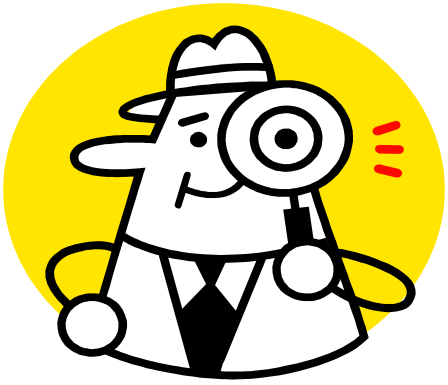
## How to Determine if an Indemnity Clause is Legal

One party, often the project owner, wants another party, usually the contractor, to pay for and shield the owner from any claims or damages that result from work on a construction project. The owner contends that the contractor controls the jobsite and is positioned to prevent such claims or damages.

Typically, the need for indemnity arises when a contractor's or subcontractor's employee is injured and sues everyone associated with the project for negligently causing the injury. Often the employee seeks punitive damages to teach the liable parties a lesson and prompt them to mend their ways and take steps in the future to lessen the chances of such injuries.

In short, the owner will not be sued without the claimant contending that the owner was somehow negligent and that such negligence helped to cause the claimant's damage. The claimant's suit will specify that the owner was negligent in some way, and should pay money to compensate the claimant.

To shift responsibility for paying



the claimant, the owner needs a legally valid indemnity clause. This article will help you determine whether the indemnity clause satisfies and is valid under Texas law.

Simply put, a legally valid indemnity clause states that one party will indemnify another for the other's own negligence. An indemnity clause cannot be subtle and still be legally effective. If the owner, for example, wants a contractor to indemnify the owner for the owner's own negligent acts, the owner must specifically demand it, stating that the contractor will reimburse the owner for the owner's own negligence.

This requirement comes from *Ethyl Corp. v. Daniel Construction Co.*, 725 S.W.2d 705 (Tex. 1987). In that case, the Texas Supreme Court announced the *express negligence doctrine* to avoid confusion in the interpretation and enforcement of indemnity provisions. The *Ethyl* case teaches that unless the owner

*(Continued as "Determine" on page 3)*

The Construction Report

**Quilling, Selander, Cummiskey & Lownds, P.C.**
**Attention: Brian W. Erikson**
**2001 Bryan Street, Suite 1800**
**Dallas, Texas 75201**
**(214) 880-1844; Fax (214) 871-2111**

*Inside This Issue:*

*—Contract Gotchas You Gotta Know*
*— Lawyer Quips and Quotes*
*—How to Determine if an Indemnity Clause is Legal*