The Construction Report

Volume 8 Issue 2 February 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; Website: *http://www.constructionreport.org*

Contract Gotchas You Gotta Know: Part II

Texas courts allow willing parties great latitude in agreeing on contract terms, and will enforce most contract provisions. Simply because one party (say the owner) proposes a provision does not mean the other has to accept it. Knowing the import of a *Contract Gotcha* is key to negotiating an equitable contract.

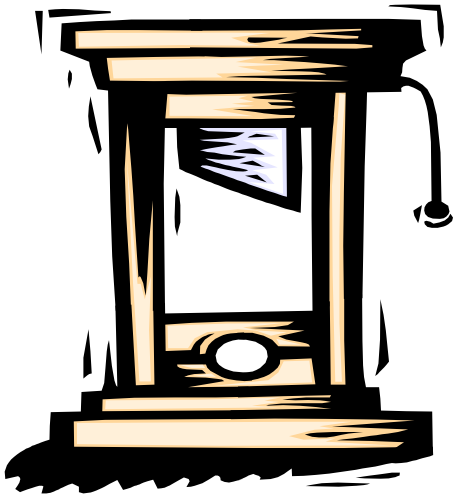
Some *Contract Gotchas* have especially draconian consequences. Part II examines the termination for convenience, decision maker, and decision is final *gotchas*.

-Termination for Convenience

Many contracts, especially public contracts, allow an owner to terminate a contract for convenience. This means that the owner can terminate or end the contract for any reason or no reason at all. The owner may have good reasons — it may lose or run out of funding. If the owner cannot secure rights of way, it may choose to terminate for convenience to avoid paying extra money to the contractor for standby or other delay costs. An owner may also use a termination for convenience provision to extract concessions. An owner can threaten to terminate for convenience unless the contractor undertakes what may be extra work for little or no extra cost, or unless the contractor drops a claim, or negotiates more reasonably. The contractor's profits may be largest at the end of the project. If terminated for convenience, the contractor will lose not only the profits, but also the prestige of having completed the project, and attending the grand opening.

With a termination for convenience, the contractor cannot recover profit for work not performed.

Ordinarily, if an owner terminates for convenience, the owner will owe for work satisfactorily performed to date, plus the reasonable costs of demobilization and cancellation of subcontracts or purchase orders. Although the owner may have to pay re-stocking costs, the owner is not liable for profit or overhead on work not performed, or for costs not actually incurred by the prime contractor.



(Continued as "Gotchas" on page 2)

Lawyer Quips and Quotes

One afternoon a lawyer was riding in his limousine when he saw two men along the road eating grass.

Disturbed, he ordered his driver to stop and he got out to investigate. He asked one man, 'Why are you eating grass?

'We don't have any money for food,' the poor man replied. 'We have to eat grass.'

'Well, then, you can come with me to my house and I'll feed you,' the lawyer said.

'But sir, I have a wife and two children with me. They are over there, under that tree.'

'Bring them along,' the lawyer replied.

Turning to the other poor man he stated, 'You come with us, also.'

The second man, in a pitiful voice, then said, 'But sir, I also have a wife and SIX children with me!' 'Bring them all, as well,' the lawyer answered.

They all entered the car, which was no easy task, even for a car as large as the lawyer's limousine. Once underway, one of the poor fellows turned to the lawyer and said, 'Sir, you are too kind. Thank you for taking all of us with you.'

The lawyer replied, 'Glad to do it. You'll really love my place. — the grass is almost a foot high.'

**

"A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty."

- Winston Churchill (1874-1965)

-TCR-

(Continued from "Gotchas" on page 1)

Often the prime contractor will insert a termination for convenience provision into its subcontracts. The prime contractor should have the right to terminate for convenience if the owner terminates the prime contract for convenience. Without such right, even though the owner has terminated for convenience, the prime contractor would still have obligations to its subcontractors to continue the project. If the prime contractor proposes a termination for convenience provision, subcontractors should seek to limit the prime contractor's right to terminate for convenience to those instances where the prime contract has itself been terminated for convenience.

-Decision Maker

The parties may validly agree to appoint someone as the decision maker for disputes. In *Tribble & Stephens Co. v. RGM Constructors, L.P.*, 154 S.W.3d 639, 652-53 (Tex.App. -- Houston [14th Dist.] 2004), the court stated that it is well established that a contract may require performance by one party to be subject to the satisfaction of the other party, or a designated third party such as an architect or engineer. Generally, a satisfaction clause will be upheld unless it is shown that the arbiter of performance under the contract decided the matter due to fraud, misconduct, or such "gross mistake" that it implies bad faith or the failure to exercise honest judgment. See *Westech Eng'g, Inc. v. Clearwater Constructors, Inc.*, 835 S.W.2d 190, 202-03 (Tex.App.-Austin 1992, no writ); *Texas Dep't of Transp. v. Jones Bros.*, 92 S.W.3d 477, 481 (Tex. 2002). It must appear from the express terms of the contract that the parties intended determination by a third party to be final – such provision may not be implied. *Delhi Pipeline Corp. v. Lewis, Inc.*, 408 S.W.2d 295, 297-98 (Tex.Civ.App.-Corpus Christi 1966), overruled on other grounds, *Tenneco Oil Co. v. Padre Drilling Co.*, 453 S.W.2d 814 (Tex. 1970).

An architect's decision may not be set aside by proving that another architect may have decided differently.

If the architect's satisfaction is required, courts generally refrain from substituting their judgment for that of the architect. *Jones Bros.*, 92 S.W.3d at 483. Indeed, an architect's decision cannot be set aside by proving that some other architect may have acted or decided an issue differently or "simply on a conflict of evidence as to what [ ]he ought to have decided. This must be true, because any other rule would simply leave the matter open for a court or jury to substitute its judgment and discretion for the judgment of the [architect]." *Westech Eng'g*, 835 S.W.2d at 203.

An owner (particularly a public owner) may choose one of its employees as the decision maker. For example, on many University of Texas projects, the school system will appoint its Chancellor as the decision maker. Other public owners may appoint their director or some senior level manager as the decision maker. For governmental entities, the internal decision making becomes part of the administrative process, with which the contractor has to comply. A contractor failing to abide by the administrative disputes resolution process specified by contract will waive or lose its right to judicial redress. On a private project, an internal decision maker will probably be held to an objective good faith standard. Either way, the contractor should comply with the terms of the decision making procedure.

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 not intended to displace the legal judgment of your attorney. Comments: Write us c/o ***Brian W. Erikson****, 2001 Bryan Street, Suite 1800, Dallas, Texas 75201. Phone:* ***(214) 880-1844****. Website:* *http://www.constructionreport.org*

-TCR-

-Decision Is Final

The contract may provide that in the event of a dispute a certain person's decision is final and binding unless the complaining party takes steps to challenge the decision either in court or through arbitration. For example, in the case *In re Global Construction Co., L.L.C.*, 166 S.W.3d 795 (Tex.App. – Houston [14th Dist.] 2005), a contractor contracted with an owner to construct an apartment complex. An incorporated provision required that disputes be submitted to the architect for decision, and that the architect's decision was final and binding unless challenged by filing for arbitration within thirty days. A payment dispute arose and the architect issued a decision that the contractor was not entitled to further payment. When the contractor did not file for arbitration within the specified thirty days, the owner filed suit for a declaratory judgment that the architect's decision was final and binding on the contractor. The trial court held that by failing to file for arbitration within thirty days, the contractor waived its right to challenge the architect's decision.

On appeal, the appellate court announced that the issue was not whether the contractor had waived its right to challenge the architect's deci-

(Continued as "Gotchas" on page 3)

(Continued from "Gotchas" on page 2)

sion as being final and binding, but who had the authority to determine the parties' respective rights – the trial court or the arbitrator. The court held that compliance with conditions precedent or prerequisites to arbitration, such as notice, time limits, laches, and estoppel, are questions for the arbitrator, not the trial court. *Id*. at 798.

The parties may incur substantial expense fighting over who determines whether a dispute remains to be decided. In *Global Construction*, it took more than three years for the appellate court to declare that the arbitrator, not the trial court, had the authority to decide whether an arbitration could proceed. The lesson: You must comply with the decision is binding provision, or risk years of satellite litigation, and perhaps never reach the true merits of the dispute.

-To be continued …

A future issue of The Construction Report will examine additional *Contract Gotchas* such as pay if paid and venue.

**

It's the job that's never started that takes the longest to finish.
-J.R.R. Tolkien (1892—1973)

The people's good is the highest law.
-Cicero (106 BC - 43 BC)

These thanks to Oscar Wilde (1854-1900):

Whenever people agree with me I always feel I must be wrong.

Always forgive your enemies; nothing annoys them so much.

A little sincerity is a dangerous thing, and a great deal of it is absolutely fatal.

Anyone who lives within their means suffers from a lack of imagination.

I am not young enough to know everything.

-TCR-

(Continued from "Recent Cases" on page 4)

gence or other fault of a contractor indemnified party; provided however subcontractor's duty hereunder shall not arise if such claims ... are caused by the sole negligence of contractor unless otherwise provided in the prime contract." The Fifth Circuit found that the language satisfied the express negligence doctrine, and held that district court had properly granted summary judgment. The court observed that in *Payne & Keller, Inc. v. P.P.G. Industries, Inc.*, 793 S.W.2d 956, 957 (Tex. 1990), the Texas Supreme Court validated an indemnity clause which stated that Payne would indemnify PPG for claims "arising out of … the acts or omissions … of [Payne] or its employees … in the performance of the work … irrespective of whether [PPG] was concurrently negligent … but excepting where the injury or death … was caused by the sole negligence of [PPG]."

Since the welder's indemnity provision had an escape clause for Kiewit's sole negligence, the insurer contended that the case needed to be remanded to the district court to determine whether Kiewit was solely or grossly negligent. However, the insurer had not pled that defense, and the district court held that the argument had been waived. The Fifth Circuit agreed.

This case also intimates that an indemnity provision that satisfies the express negligence doctrine can subject the indemnitor to liability for the indemnitee's gross negligence, an undefined but potentially very large amount of money.

**

Royce Homes, L.P. v. Humphrey, __ S.W.3d __, 2007 WL 4623335 (Tex.App. – Beaumont January 3, 2008). This case is interesting for two reasons. First, it explores a builder's liability for flooding adjoining property. Second, it examines "stigma damages".

Humphrey lived next to a new home that Royce was constructing. After his home was flooded with water from next door, Humphrey sued Royce, alleging that the homebuilder wrongfully diverted the natural flow of surface waters, causing Humphrey's home to flood. The Texas Surface Water Act, Section 11.086 of the Texas Water Code, permits a person damaged by an overflow of water from an unlawful diversion or impounding to sue for damages and equitable relief. Humphrey claimed that Royce owed the costs of repair plus stigma damages since the home had been flooded, and may do so

again. At trial, the jury found for Humphrey and awarded repairs costs and loss of market value due to the stigma of a previous flood.

On appeal, the appellate court recognized the concept of stigma damages, that is, a monetary award for a permanent reduction in value of a house due to flooding. However, the court held that Humphrey's real estate expert's testimony was based on speculation, and lacked a reliable foundation. Since the court found that there was some support for stigma damages, the court remanded the case for a new trial in the interests of justice.

Stigma damages may be applicable to foundation repair, mold abatement, and other cases potentially involving a queasy buyer.

-TCR-

Recent Cases of Note: Indemnity & Flooding

Indemnity is a significant issue especially where an innocent subcontractor is required to indemnify an owner or the prime contractor from the consequences of their own negligence. The exact words needed to effect indemnity often lead to argument.

In *XL Specialty Ins. Co. v. Kiewit Offshore Services, Ltd.*, __ F.3d __, 2008 WL 40107 (5th Cir. January 2, 2008), Kiewit was the prime contractor for a bridge project. Kiewit subcontracted with a welder for certain welding. Two employees of the welder died when their welding caused an explosion in a confined space. Heirs of the employees sued the welder and Kiewit. Kiewit demanded indemnity from the welder.

The welder's primary and excess liability insurers denied the indemnity claim. The welder and its insurer settled with one of its employee's heirs for $4 million. Kiewit later settled with that employee's heirs for $4 million. The

welder and its insurer sued Kiewit seeking a declaratory judgment that they had no obligation to indemnify the prime contractor for the claims by the deceased employees' heirs. Kiewit filed a third party claim against the welder and a cross claim against the insurers asserting that the welder had a contractual duty to defend and indemnify Kiewit. The district court granted summary judgment to Kiewit holding that the welder had contracted to indemnify Kiewit for Kiewit's negligence with respect to the explosion and that the insurance policy provided coverage.

On appeal, the Fifth Circuit examined the indemnity provision to see if it satisfied the Texas Supreme Court's express negligence doctrine. This doctrine disallows indemnity unless the indemnity provision expressly provides that the indemnitor will indemnify the indemnitee for the consequences of the indemnitee's own negligence.

The indemnity provision at issue required the welder to "defend and indemnify [Kiewit] from any and all claims ... whether or not caused in part by the active or passive negli-

(Continued as "Recent Cases" 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
Website: *http://www.constructionreport.org*

Inside This Issue: