

Design-Build vs. Traditional Construction: Risk and Benefit Analysis

I. Project Delivery Method Options and Answers

A. The Traditional Approach: Design/Bid/Build

In the traditional project, an owner selects an architect or engineer to design plans and specifications. See Figure 1, below. The design professionals analyze the owner's needs and develop design concepts. They then prepare design development drawings, and then construction drawings. Once the design has been fully completed and the construction drawings finished and reviewed by the owner, the project is advertised for bids. Contractors pick up the bid solicitation materials and review a full set of plans and specifications to prepare a bid proposal. If the contractor's price is acceptable, the owner will sign a contract with the contractor and construction can then begin.

B. When Fast Track Construction Works Best

In contrast, with fast track construction, the contractor is selected early in the process -- long before the plans and specifications are complete, and sometimes before the design has even begun. The contractor assists with design development and submits a price proposal before the drawings are complete. Usually, the contractor provides a guaranteed maximum cost, including the contractor's fee, and perhaps some contingencies and allowances. Construction starts well before the construction drawings are finished. The designers focus first on the site work, and foundation. While the contractor is moving dirt, and constructing the foundation, the designers prepare drawings for the rest of the project. Some of the design may even be design build (more on that later). As

construction progresses, the designers struggle to keep ahead of the contractor. If all goes well, the fast tracked project will complete in much less time than the traditional project.

The principal advantage of fast track construction is time. The project starts well before the completion of the design and may even finish shortly after the last drawing is released. If all goes well, a project that is fast tracked may complete before the construction contract is even signed on a traditional project. For those projects where time is real money, fast tracking is an option. If a manufacturing plant is needed yesterday, and construction has not yet begun, fast tracking may be viable. In the 1970's when inflation was out of control, fast tracking helped to avoid some of the price increases.

Fast tracking also allows the contractor an early opportunity to provide design input and value engineering. The relationship between the parties should be less confrontational since the contractor is usually not bound to a fixed lump sum price.

However, fast tracking is not cheap and has considerable risks. New drawings arrive about every day. There may be coordination problems between drawings, or with existing construction. The contractor is not always able to construct exactly what is shown on the drawings due to field or existing conditions. When the contractor makes changes, the changes need to be immediately communicated to and coordinated with the designer.

C. The Inherent Challenges in Multiple Primes

Well into the 1800's, the primary approach to construction was the “master builder” who not only designed the project, but also constructed it. For most of this century, however, construction projects have been managed jointly by the triumvirate of the owner, designer, and general contractor.

Under this approach, the contractor and designer typically exercised day to day control, although the owner has at least nominal control, thanks to the power of its purse. (Remember the Golden Rule: He who has the gold makes the rules.) This traditional approach involved a single prime contractor who contracted directly with the owner. The general contractor then signed subcontracts with key trade contractors (electrical, mechanical, plumbing, etc.), and acted as the site manager during construction. *See* Figure 1. The general contractor answered for the quality, cost, and timeliness of the work. The general contractor also assumed responsibility for site safety.

The designer traditionally observed the construction to verify general conformance with the plans and specifications and the other contract documents. The designer also visited the site to determine the percentage of completion and to assess the propriety of the contractor's applications for payment.

In a multiple prime arrangement, the owner hires various prime contractors (usually, the trade contractors, electrical, mechanical, plumbing, etc.) to perform and control the different portions of the work. There is no general contractor. Each prime contractor is independently responsible to the owner for the cost, timeliness, and quality of the work under its respective contract. The owner acts as its own general contractor or hires a construction manager to control the project. *See* Figure 2. Under this approach, the various prime contracts must clearly define responsibilities for construction, supervision of the work, site safety, and contract administration, since accountability for the whole of the work is now fragmented among several entities.

If the owner is not a sophisticated and effective manager, retaining multiple primes is an accident waiting to happen. Coordination problems are bound to arise if the work of each trade contractor is not scheduled appropriately. If the trade contractors mobilize only to discover that the

project has not progressed sufficiently to accommodate them, or that another trade has had to disturb their work to do their own, there may be significant delay and disruption claims, and massive litigation. For example, in *Maintenance Corp. v. Rutgers*, 90 N.J. 223, 447 A.2d 906 (1982), the owner's contracts with each of several primes stated that time was of the essence. When delays occurred, and complex litigation began, the court held that each prime contractor was an intended beneficiary of the owner's contracts with the other primes and had standing to sue the others for delay damages. The single biggest winners there were the lawyers.

Choosing multiple primes may save a substantial amount of money. Typically, the general contractor marks up the costs of its subcontractors and materials. This markup covers the general contractor's administration costs and some of its risks. Often, in negotiating the subcontract prices (known in the trade as "buying out the subcontracts"), the general contractor will reap considerable savings over its estimated costs. With multiple primes, the owner benefits directly from any savings on subcontract buyout, and avoids the general contractor's markup on subcontracts and materials.

D. Common Setbacks Arising in Design/Build Contracting

While the design build concept is not new, its expansive use is a recent phenomenon. The Texas Education Code, §41.031, now allows schools to make widespread use of design building. Section 41.031 permits schools to avoid competitive bidding for school construction projects by contracting for a design built school. There are several variations of the design build concept, but the two main approaches are the Design Build Team, and Sole Design Builder.

1. Design Build Team

Under the Design Build Team approach, an architect or engineer and a contractor join forces

to form a joint venture to design and build a project. The team negotiates with an owner or submits a competitive proposal for both the project's design and construction. An advantage of this approach is the early involvement of the general contractor in the design phase. Having the contractor involved early allows for better coordination with the designer and among the various aspects of the design. The contractor and designer are motivated to work and play well together since they are team members. This can also be a disadvantage. The designer no longer is principally the owner's agent, and is partners with the contractor. This disadvantage can also be an advantage if the owner makes both designer and contractor responsible for the ultimate project. The owner can then look to the team if anything is amiss, and avoid finger pointing between designer and contractor.

2. Sole Design Builder

Under this approach, one firm contracts with the owner to be responsible for both the design and construction of the project. That firm then retains design expertise and construction capability suitable for the project. An advantage is a greater turn key approach with one firm responsible for the entire project. Another advantage is the firm's ability to specialize in particular projects, like schools. Building a great number of a particular type of project gains the firm a verifiable track record. The owner can inspect prior projects for imagination, form, and function. A disadvantage is the lack of independent and critical analysis from separate design and construction firms. This disadvantage has less impact if the owner has some expertise and can capably review the design and construction of the project.

3. Design Build Developer

With this approach, the owner contracts with a commercial developer, who usually lacks the credentials of a designer or a contractor. This approach is suitable for the owner who has little or

no construction experience, and owns few other projects. The design build developer can supply the expertise to oversee the design and construction of projects for those owners who lack the necessary in-house staff. This way the owner can retain the experience necessary to develop the project properly, from selection of designer and contractor to handling of governmental permits and other matters. This form of design building is often used for build to suit projects.

4. Advantages

The principal advantage of design building is that the owner can hold one party accountable for the design and construction of the entire project. With the traditional approach, responsibility is not always clear. A single point of contact relieves the owner of the need to coordinate the designer with the contractor, a primary cause of construction disputes and cost overruns. Design building may reduce the management time that the owner would ordinarily expend on the project. While the owner must still have a designated construction representative to review the project construction, the representative's time is not consumed with handling the communications and conflicts that arise between the designer and contractor.

Design building should result in a lower overall cost and a faster completion of the construction project. A design builder with the responsibility for all of the project is often willing to charge the owner a lower fee than the combined fee for the architect/engineer and contractor under the traditional approach. The design build approach is better suited for fast track construction. As the design unfolds in a fast track project, communication between the designer and contractor is crucial. With a design builder, communication is facilitated and the design and construction is better coordinated.

The principal pitfall of design building can be the design builder's weakness in anticipating

the owner's needs for the project. Intense consultation and communication with the owner before the project design begins is incredibly important. Some design builders will move into an owner's existing projects for a lengthy period to assess and evaluate the efficiency and functionality of the project, consulting with the owner on a daily basis to discover and resolve problems. These consultations should involve the owner's lower management and persons actually performing the owner's work. Otherwise, the owner may not even mention critical aspects of its operations, figuring that they were obvious. The owner may have developed improvements or have unique situations for which the design builder needs to account. For example, the owner may have handicapped workers who perform certain tasks. The design builder needs to ensure access for the handicapped workers. Time spent observing the owner's operations would have shown this need.

Under the traditional method of construction, the designer owes the owner (the designer's client) a clear duty to exercise professional judgment in a manner that gives the owner the best project for the most reasonable price. The design builder has this same responsibility since it has agreed to design the project. Performing this duty in a successful and impartial manner, however, may be at odds with the design builder's motivation to cheapen the construction, regardless of impact on the owner's needs. If the designer is an employee of the design builder, the design builder is in a position to direct a design decision that in the judgment of the designer does not best serve the owner's interest. There is an inherent conflict between the designer's duty to the owner and to his employer. The design builder should have safeguards to ensure that the designer will act in the owner's best interest, even if the design builder insists on something else. In other words, there must be mechanism in place so that the designer still owes an independent duty to the owner. In entering into a design build contract, the owner must make the parties recognize the potential conflict the

designer faces and acknowledge the independent duty the designer owes to the owner, regardless of actual employer.

The design build approach also eliminates the checks and balances present when the designer and contractor are separate. Under the traditional approach, the designer will closely examine a contractor's performance to determine whether it meets specifications and justifies payment. Contractors, on the other hand, may suggest value-engineering proposals if the design is too costly to construct. While the owner may pay more to separate design and construction responsibilities, many owners believe that these controls are worth the price.

Another risk the owner faces is that the owner must rely solely on the design builder for compensation if the project is not successful. Some owners prefer having multiple parties -- architect, engineer, and trade contractors -- potentially liable for damages. Multiple parties tend to create a larger pool of funds, especially if the insurance carriers and bonding companies of the parties are included.

5. Pricing

Often, a design built project will be priced by a guaranteed maximum. With a guaranteed maximum price, the design builder must deliver the project at or under the guaranteed price. The contract should have a savings clause, with the owner benefitting from some or most of the savings. This should entice the design builder to use its experience, imagination, and creativity to benefit both parties.

The design builder may submit a lump sum price, or negotiate a price with the owner. The design builder may be one of several interested in performing the work. The owner may take competitive bids or proposals or negotiate with the bidders before or after the bids or proposals.

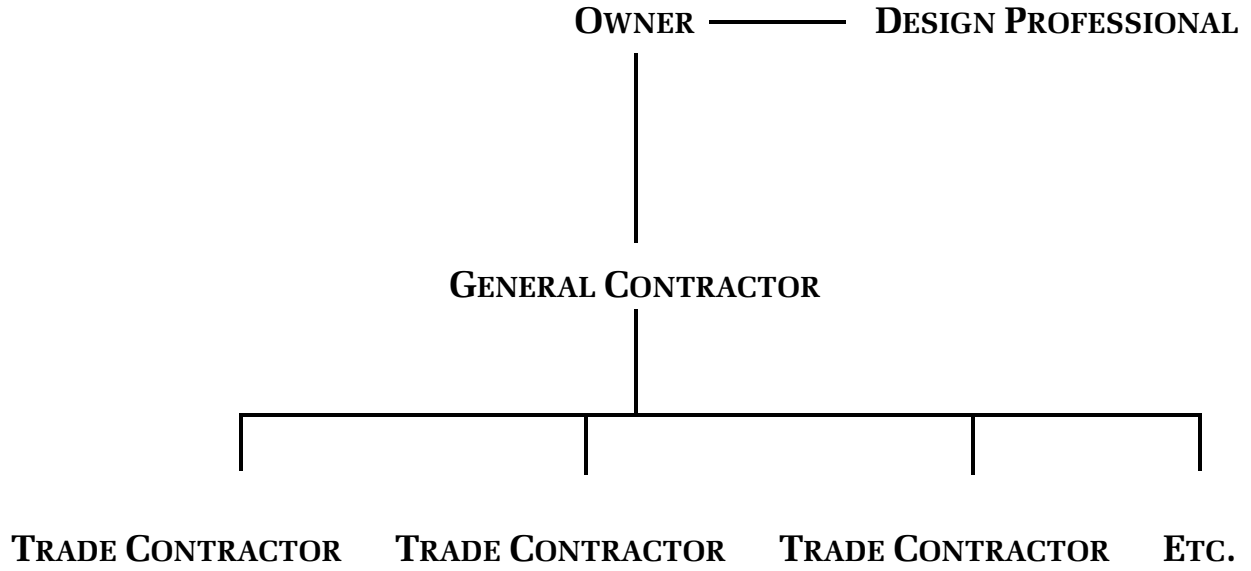


FIGURE 1. TRADITIONAL ORGANIZATIONAL CHART

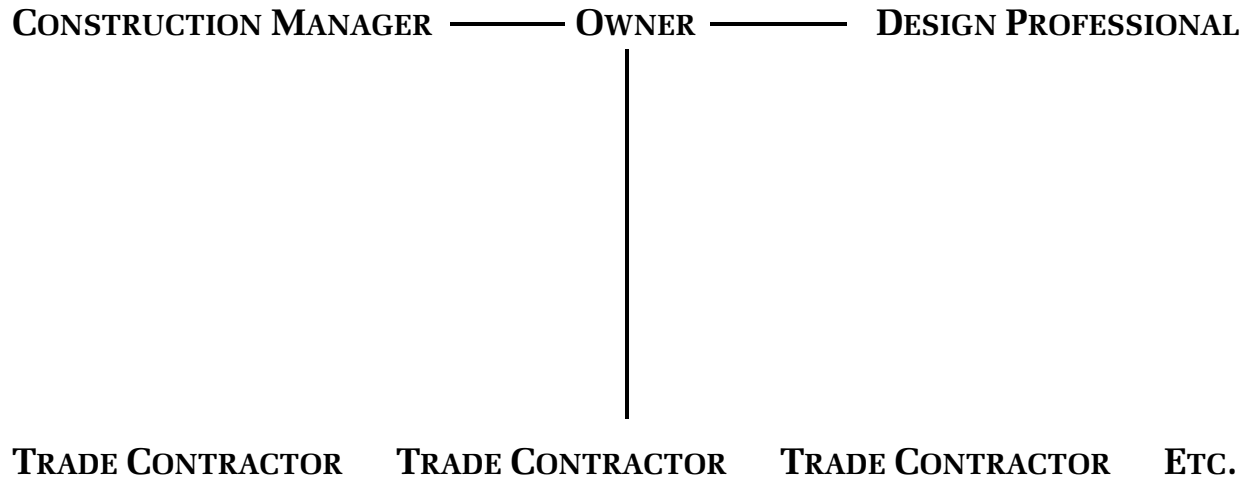


FIGURE 2. CONSTRUCTION MANAGER (SANS GENERAL CONTRACTOR) ORGANIZATIONAL CHART

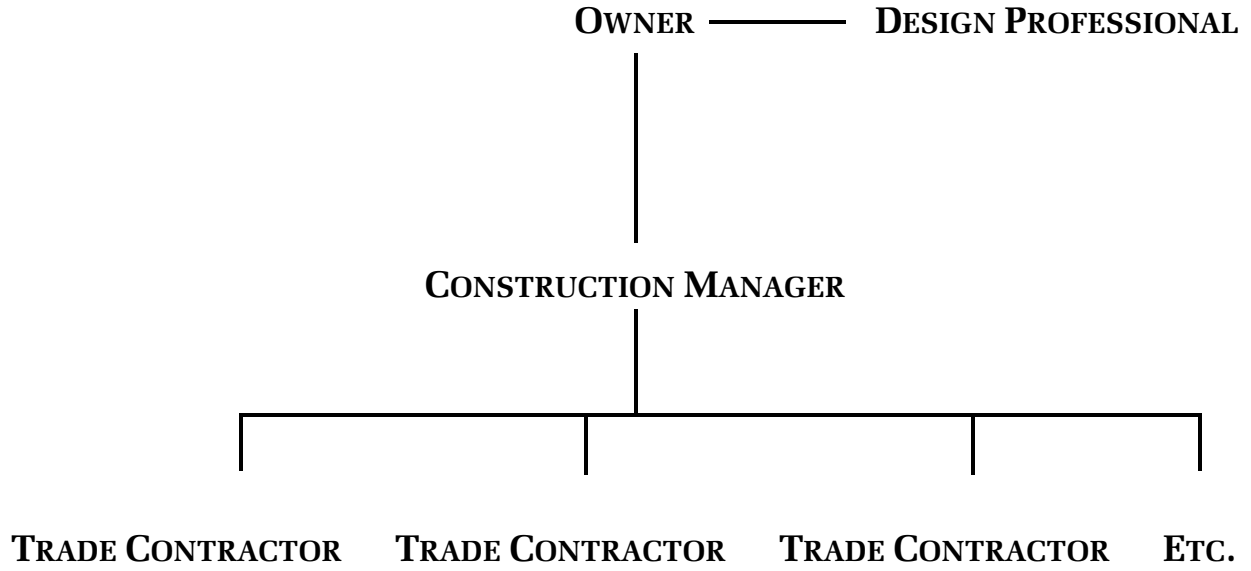
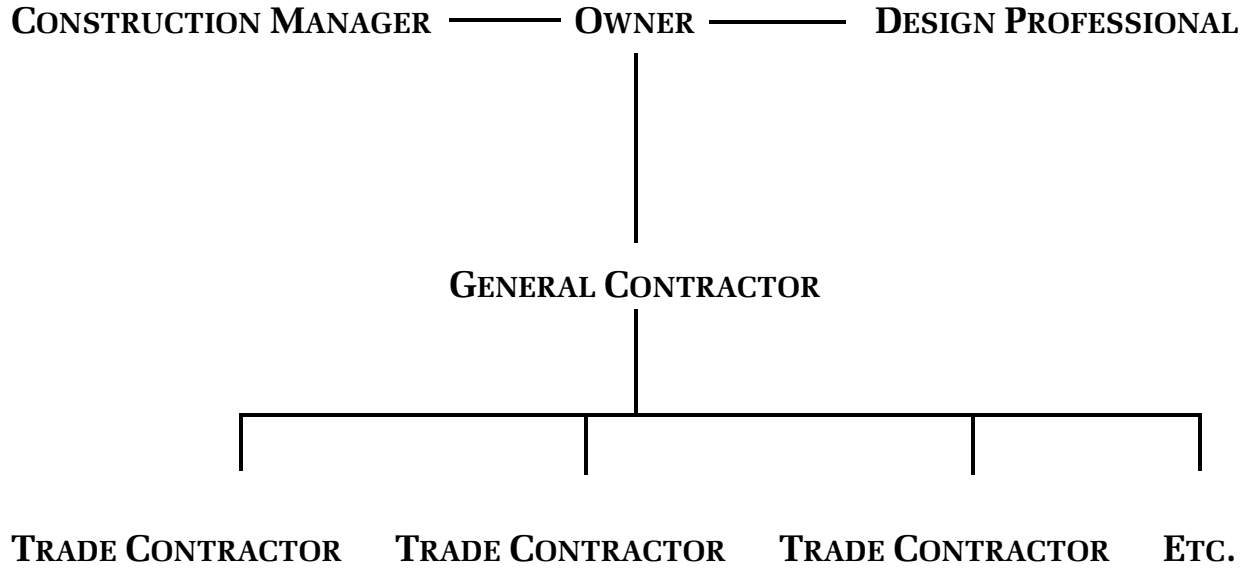


FIGURE 3. CONSTRUCTION MANAGER AT RISK ORGANIZATIONAL CHART



**FIGURE 4. GENERAL CONTRACTOR - CONSTRUCTION
MANAGER ORGANIZATIONAL CHART**

D. Common Setbacks Arising in Design/Build Contracting

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E. Which Projects Are Most Suitable for CM/GC and Other Hybrid Approaches

The presence of a construction manager fundamentally changes the allocation of control on a project. The role of a construction manager is a relatively recent development, and allows great variability. Generally, the construction manager assumes most (but not all) of the job site management and administrative duties that would otherwise be performed by either the designer or a general contractor. These duties include conducting thorough site inspections as the work

progresses, issuing or initiating certificates for payment, monitoring compliance with the construction schedule and revising the schedule when needed, participating in the change order process, monitoring compliance with environmental and safety laws and regulations, arranging for inspections by public officials, and coordinating the work of multiple primes and/or specialty trades.

A construction manager's official duties are defined by its agreement with the owner. However, because the construction manager's contract language has not been well tested by the courts, there is no telling what "official" duties may be imposed if the contract is not clear.

In *Gibson v. Heiman*, 261 Ark. 236, 547 S.W.2d 111 (1977), the Arkansas Supreme Court was faced with a construction management contract which it found to be ambiguous because it did not list or define the construction manager's duties. The court ruled that the manager must be viewed as the owner's representative during construction -- a duty typically reserved for the design professional. Because the court concluded that the construction manager had not fully performed its contractual duty to represent the owner's interests, it held that the manager could not recover the balance due under the contract.

The benefits of hiring a construction manager include better overall coordination of the work and greater attention to cost and schedule control. However, the presence of a construction manager does not always simplify project management. Published form construction management contracts still envision a design professional with some role in the project during construction, and the owner still having at least some nominal control. Although the use of a construction manager may improve coordination, it also increases the potential for fragmented control by adding another "controlling" participant.

The construction manager's scope of duties may vary considerably. The construction

manager may or may not guarantee the cost of construction. With a construction cost guarantee, the construction manager usually issues a guaranteed maximum cost similar to that submitted by a general contractor. If the construction manager has guaranteed the cost, the construction manager is considered to be “at risk” for the construction cost. With the construction manager at risk, it will often contract as the owner’s agent with the various trade contractors. *See* Figure 3. This arrangement provides the construction manager with control sufficient to accept the risk of the guaranteed cost. In return, the owner saves the markup of the general contractor on the subcontractors and materials.

For greater control over project scheduling and coordination, the owner may retain a general contractor as well as a construction manager. *See* Figure 4. With this arrangement, the general contractor retains subcontractors and oversees the purchases of materials, as usual. The construction manager acts as the owner’s agent during the project. The construction manager coordinates the scheduling and monitors the change order, and payment application process. The construction manager enforces the contract terms, and acts as an arbiter of the contract documents. The general contractor reports to the construction manager in the general course of the project.

F. Overcoming Obstacles When Implementing Best Value Procurements

John Ruskin, a 19th century art critic and social commentator, once said, "It's unwise to pay too much, but it's also unwise to pay too little. When you pay too much, you lose a little money, that is all. When you pay too little, you sometimes lose everything because the thing you bought was incapable of doing the thing it was bought to do."

Ruskin's comments have proved true for more than 100 years, and help public procurement

professionals stretch taxpayer dollars.

The best value for a product or service may not be delivered by the lowest bidder. Cost is one of several factors to consider when using the best value procurement process.

In its broadest sense, best value may be defined as the outcome of any acquisition that ensures customer needs are met in the most effective, timely, and economical manner. Finding the best value should be the ultimate goal of every acquisition.

1. Federal Construction Contracting

Best value procurement was introduced to the federal acquisition system through legislative and regulatory initiatives. The Clinger-Cohen Act of 1996 enacted design-build procurement for the federal government. The Act describes the two-phase selection procedure and the concept of "efficient competition." The Act defines "efficient competition" as a balance between the need "to obtain full and open competition" and "the need to efficiently fulfill the Government's requirements." The statute codifies the design-build construction method popular in the private sector. The Federal Acquisition Regulation (FAR) implements the Clinger-Cohen Act and the two-phase design-build process for federal procurement.

However, the statutes and regulations provide only a procedure to use best value procurement; they do not require an agency to use best value procurement. The two-phase procedures "are generally appropriate for unusual or complex projects for which technical competence and demonstrated past performance are critical." If the government agency determines the two-phase design-build procedure is appropriate for its project, it must create a "scope of work" statement that "defines the project and states the Government's requirements."

A. Two-Phase Procedure

In Phase 1, the government narrows the field of potential bidders to a short list of no more than five of the best qualified design-build contractors without looking at price. During Phase 2, the government selects the design-build contractor who provides the "best value" based on all appropriate factors, including price.

(1) Phase 1

After the agency determines that design-build procedures are appropriate and creates the scope of work statement, it issues a solicitation. The solicitation incorporates the scope of work statement along with the evaluation factors the agency will consider. These factors include specialized experience and technical competence, capability to perform, past performance of the offeror's team (including the architect-engineer and construction members), other appropriate factors (excluding cost or price-related factors, which are not permitted in Phase 1). Importantly, Phase 1 does not include detailed design or pricing information. Nor do the regulations limit the discussions the government may have with offerors during the selection of the short list.

The explicit exclusion of cost or price data from Phase 1 sets the design-build procedure apart from the traditional competitive process. By excluding cost or price data, the design-build method permits agencies to focus on other important aspects of bid proposals. The offeror is able to focus on the design quality and technical requirements of a complex project without regard to price. During this phase, the government may evaluate the proposals without fear that the competitors simply are trying to under-bid each other regardless of the impact on the project. Furthermore, the offeror benefits from the reduced proposal preparation expenses because it does not have to produce a detailed cost analysis unless it is selected to enter Phase 2.

The FAR defines past performance information as:

relevant information for future source selection purposes, regarding a contractor's action under previously awarded contracts. It includes, for example, the contractor's record of conforming to contract requirements and to standards of good workmanship; the contractor's record of forecasting and controlling costs; the contractor's adherence to contract schedules, including the administrative aspects of performance; the contractor's history of reasonable and cooperative behavior and commitment to customer satisfaction; and generally, the contractor's business-like concern for the interest of the customer.

See 48 CFR §42.1501. The FAR definition is subjective and permits the government agency to exercise broad discretion. Thus, the government has wide latitude in establishing a contractor's performance rating. The burden is on the government agency to maintain information on contractor past performance and to prepare a past performance evaluation report for each competing contractor. 48 CFR §§42.1500 to 42.1503. However, contractors are permitted to "submit comments, rebutting statements, or additional information" relating to the evaluation. 48 CFR §42.1503. In the event of a disagreement, discrepancies are resolved "at a level above the contracting officer." 48 CFR §42.1503. Ultimately, the contracting agency retains the final decision regarding content of the past performance evaluation. *Id.* Finally, the solicitations must describe the approach for evaluating past performance information, including how the agency will evaluate offers when no past performance information is available. 48 CFR §15.305 (a) (2) (iv). General Accounting Office decisions indicate that when there is a lack of past performance information, "the offeror may not be evaluated

favorably or unfavorably on past performance."

Phase 1 narrows the field of offerors based primarily on technical competence and past performance. The result is a short list of contractors best qualified to compete in Phase 2. 10 U.S.C. §2305a (c) (2). Generally, this short list is limited to five contractors. 10 U.S.C. §§2305a (c) (4) to 2305a (d). The list may include more than five contractors only if the greater number of competitors is in "the Government's interest and is consistent with the purposes and objectives of two-phase design-build contracting." 48 CFR §36.303-1 (a) (4). This short list will thus include only those competitors likely to provide "best value" to the government.

(2) Phase 2

After the agency creates the short list, the competitors must comply with the solicitation requirements for Phase 2. The solicitation may be issued concurrently with the Phase 1 solicitation or after creation of the short list. 48 CFR §36.303. The Phase 2 solicitation "shall require submission of technical and price proposals, which shall be evaluated separately, in accordance with Part 15." 48 CFR §36.303-2 (b). The agency must indicate in the solicitation all factors to be considered and their relative importance. 48 CFR §15.304; 10 U.S.C. §2305 (a) (2) (A) (I); 41 U.S.C. §253a (b) (1) (A). After the 1997 revisions to FAR Part 15, the government has significant discretion and flexibility during the two-phase process. The regulations require that competitors "shall be treated fairly and impartially but need not be treated the same." 48 CFR §1.102-2 (c) (3). One recent analysis of the current FAR regulations for Phase 2 noted "[t]he rewrite encourages pre-solicitation conferences, one-on-one meetings, and even draft requests for proposals concerning future contracting opportunities." FAR §15.201 (c); FAR §15.201 (f).

FAR Part 15 also permits the government to negotiate with competitors to achieve "best value." 48 CFR §15.306 (d). FAR §15.306 (d) defines negotiation or bargaining as "persuasion, alteration of assumptions and positions, give and take, and may apply to price, schedule, technical requirements, type of contract, or other terms of a proposed contract." *Id.* The government may also:

[N]egotiate with offerors for increased performance beyond any mandatory minimums, and the Government may suggest to offerors that have exceeded any mandatory minimums (in ways that are not integral to the design), that their proposals would be more competitive if the excesses were removed and the offered price decreased.

48 CFR §15.306 (d) (3). Finally, each offeror has the opportunity to revise its proposal during the negotiations and to submit a "final proposal revision." 48 CFR §15.307 (b). However, the regulations prohibit conduct that favors one offeror over another, that reveals an offeror's technical solution, or that reveals an offeror's price without that offeror's permission. 48 CFR §15.306 (e). These regulations give government agencies "considerable discretion" in the procurement process.

During Phase 2, the evaluating agency may consider cost information. 48 CFR §15.305 (a) (4). The best value procurement method permits the agency to "conduct a price/technical trade-off analysis of an offeror's technical proposal and prices in order to determine which proposal is most advantageous to the government" and, thus, "make an award to a higher priced offeror that has submitted a technically superior offer." 48 CFR §15.101-1; 48 CFR §15.305 (a) (4).

The criteria for evaluation is critical for implementing a best value procurement, and requires forethought and planning. A sample evaluation follows.

EVALUATION CRITERIA SCORE SHEET (ASSIGN NUMERICAL VALUE)

Evaluation Criteria	Vendor 1	Vendor 2	Vendor 3	Vendor 4
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-Technical/Management

1. Technical & Organizational

Approach

2. Qualification of Personnel

3. Resource Commitment

4. Past Performance

-Overall Proposal Rating

-Overall Cost to Agency

-Best Value Solicitation

-Weighing The Options

According to the U.S. Army Materiel Command's *Army Source Selection Guide*, the general rule is: the higher the technical or performance risk, the greater the emphasis on non-cost factors. To that end, civilian procurements of professional services and construction and information technology (IT) contracts, which tend to be complex, may be handled through the best value process. Best value procurement is also appropriate for the purchase of goods such as HVAC equipment, office furniture and equipment, and copiers.

2. Measuring What's Relevant

There are a number of source selection factors to consider when using the best value procurement method. (See inset below.) The user should be wary of using too many. Whatever factors are selected should be based on requirements and should relate directly to the goods and

services being procured. If too many evaluation criteria are employed, the process will dilute consideration of those that are truly important.

Life Cycle Costing (LCC) can be an effective tool to measure the value of offers. LCC goes beyond the total acquisition cost. It also measures total operation and maintenance costs minus any residual value remaining after the useful life of the product is expended. The Total Cost of Ownership is another important factor. For example, this factor considers the initial price of the purchase, the cost of maintenance over a specified number of years, and the cost of consumables. The vendors' performance history is also an important factor in evaluating a best value contract. The private sector has long looked to contractors' current and past performance as a major criterion in selecting suppliers. However, any time that subjectivity is allowed into an evaluation process, the door is open for reasonable minds to differ on the outcome.

The public sector has traditionally relied more on detailed technical and management proposals to compare offers. This practice often allowed vendors who could write outstanding proposals to win contracts, even though competing offerors had significantly better performance records and, therefore, offered a higher probability of meeting contract requirements.

The Office of Federal Procurement Policy (“OFPP”) encourages agencies to make contractors' performance records a key consideration in awarding negotiated acquisitions, reasoning that the result would be increased competition and higher quality service by vendors.

3. Assessing the Advantages

Using best value procurement can encourage and increase small, women-owned, and minority business participation and subcontracting opportunities. In addition, best value

procurements can take advantage of the experience and independent judgment of evaluators and offer greater flexibility to compare technical and cost factors subjectively. Best value procurements do, however, require time and resources to complete and may be difficult to evaluate. As with other selection processes, best value procurement has advantages and disadvantages, and is simply a tool to accomplish a procurement.

A best value procurement process cannot be objectively measured and increases the potential for additional protest.

4. Calibrating for Control

The make up of the evaluation team depends on the nature of the purchasing requirement. At a minimum, the team should include end users, technical experts, contract administrators, procurement professionals, and, if necessary, legal counsel. Before conducting a best value procurement, it may be helpful to have a pre-solicitation dialogue to ensure a mutual understanding of the agency's needs and vendors' capabilities. Such a meeting could help reduce miscommunication and protest. The team should develop a means of evaluating the merits of bid proposals so that their relative strengths and short comings can be compared.

RATING	ADJECTIVAL DESCRIPTION
Exceptional	Bid exceeds requirements and demonstrates an exceptional understanding of goals and objectives of the acquisition. One or more major strengths exist. No significant weaknesses exist.
Acceptable	Bid demonstrates an acceptable understanding of goals and objectives of the

acquisition. There may be both strengths and weaknesses, but the strengths outweigh the weaknesses.

Bid demonstrates a fair understanding of the goals and objectives of the

Marginal acquisition. Weaknesses outbalance any strengths that exist. Weaknesses will be difficult to correct.

Bid fails to meet an understanding of the goals and objectives of the

Unacceptable acquisition. The proposal has one or more significant weaknesses that will be very difficult or impossible to correct.

Once a need has been identified, an agency must decide on a rating method. The numeric rating uses a balanced scorecard, with points generally totaling 100. The color rating method uses red, yellow, and green to rate proposals. The adjectival rating method uses descriptions. Others use a rating system from one to five, with five being the best. The actual system used is not as important as whether the evaluators all understand the system and use the same system. Ratings should reflect how well contractors meet the cost, schedule, and performance requirements of a contract. In addition, the OFPP stresses the importance of including a narrative sentence with each rating, recognizing contractor resourcefulness in over-coming challenges that arise in the context of contract performance. Price, while not the only factor weighed in a best value contract, is still important.

Vendors have had mixed reactions to best value contracts. Some feel uncertainty about the prospects of future contracts because of the subjectivity involved and the fact that the lowest price does not guarantee contract award. Others appreciate the process more because they feel that it levels the playing field concerning product and service quality while not making price the

determining factor. Communication with disappointed vendors after the an award may help alleviate vendor concerns. A debriefing session with the unsuccessful bidders can even help improve the response to future requests for proposal.

Best value procurement is not a new concept. Rather, it is a practice that is being used more now than in the past. In 1989, for example, the U.S. Navy began employing a methodology for "greatest value source selection" of firm-fixed price supplies in which cost and past performance were the only award factors. The name has changed over time. Some request for proposal processes are simply best value procurements. Typically, a request for proposal process can equate to the best value procurement process when consideration is given to factors other than cost. Legislative changes have allowed the process to take place. As state laws have been changed to permit more best value procurements, the process has gained more acceptance.

Typical best value source selection factors

- Life cycle costing/Total cost of ownership
- Quality of goods or services
- User friendliness
- Proposed technical

performance

Financial stability of

vendor

Timeliness

Cost of necessary

training

Qualifications of

individuals

proposed for a

project

Realistic risk

assessment of the

proposed solution

Availability and cost of

technical support

Environmental impact

Past performance

Cost/price

G. Special Concerns for Public Works Projects

1. No implied duty of contractual good faith

There is no implied duty of good faith in performing a contract in Texas. The Texas Supreme Court so held in *English v. Fischer*, 660 S.W.2d 521 (Tex. 1983), where it refused to hold that “in every contract there is an implied covenant that neither party will do anything which injures the right of the other party to receive benefits of the agreement.”

The case *City of San Antonio v. Forgy*, 769 S.W.2d 293 (Tex.App. -- San Antonio 1989, writ denied), illustrates the problem with no duty of good faith. There, a metal casing around a water well ruptured, and the contractor had to drill a second well at considerable expense. During discovery in the ensuing suit, the contractor found out that the City’s engineer knew before hand that the casing was undersized and was likely to rupture. Despite the City’s prior knowledge that the casing would fail, the court refused to impose a duty of good faith on the City in its dealings with the contractor.

2. Sovereign Immunity

The State of Texas (including State agencies, and universities) retains sovereign immunity. As a result, sovereign or governmental immunity protects the State, its agencies, and its officials from lawsuits for damages, absent the Legislature's consent through statute or legislative resolution. *Texas Natural Resources Conservation Comm'n v. It-Davy*, 74 S.W.3d 849, 853-54 (Tex.2002); *Federal Sign v. Texas Southern University*, 951 S.W.2d 401, 405 (Tex.1997); *City of Texarkana v. Cities of New Boston*, 141 S.W.3d 778, 781 (Tex.App.-Texarkana 2004, no pet.). Governmental immunity encompasses both immunity from liability and immunity from suit. *It-Davy*, 74 S.W.3d at 853.

Immunity from liability protects the State from judgments even if the Legislature has expressly given consent to the suit. *Federal Sign*, 951 S.W.2d at 405. When the State contracts, the State waives immunity from liability. *Id.* However, immunity from suit still bars a suit against the State unless the State expressly consents to the suit. *City of Texarkana*, 141 S.W.3d at 785.

3. Differing Site Conditions

Differing site conditions are essentially conditions which differ in some degree from that which the parties expected. One way of managing differing site conditions is to include a differing site conditions clause in the contract. Differing site conditions clauses seek to allocate equitably an unknown risk between the owner and the contractor. In theory, this equitable apportionment should minimize costs to the owner because it allows the contractor to remove this contingency from its bid. The owner avoids overpayment on the majority of projects and is required to pay for differing site conditions only when they occur.

Despite the theory supporting inclusion, there are good reasons not to include a differing site conditions clause in the contract. Those owners who do not often build may not generate the experience sufficient to realize the cost savings of contractor's removal of the differing site conditions risk. An owner who rarely engages in construction may be more concerned with the potential for a catastrophic cost overrun than the incrementally higher construction cost that the differing site conditions clause may cause. Second, some owners, particularly public owners, have limited funds for the construction of a project. Substantially increasing the project budget to accommodate a changed condition may be impractical. Third, placing the risk on the contractor provides the contractor with an incentive to minimize the financial effect of the discovered condition.

If the contract has a differing site conditions clause, the contractor may see the changed condition as an opportunity to recoup other losses on the project at the owner's expense. Finally, in a competitive market, empirical evidence indicates that contractors do not quantify the risk of differing site conditions and may undervalue the risk. Under these conditions, elimination of the differing site conditions clause benefits the owner at little or no cost.

Federal Government contracts contain a standard provision relating to differing site conditions, which takes precedence over any contrary language in the contract. These standard provisions are often included in federally funded work for states and local governments. The federal provision recognizes two types of differing site conditions. A Type I claim provides for an equitable adjustment if the conditions encountered differ materially from those indicated in the contract. Although the representation of the conditions need not be explicit, the contract documents must provide sufficient grounds to justify a bidder's expectation of latent conditions materially different from those actually encountered.

When the contract documents do not contain affirmative misrepresentations as to anticipated conditions, a contractor's right to a contract adjustment may nonetheless arise from unusual physical conditions differing materially from those ordinarily encountered in work of the character provided in the contract. These claims are generally referred to as Type II claims.

The federal differing site conditions clause is listed in the Code of Federal Regulations, 48 C.F.R. §52.236-2 (1991), as follows:

- (a) The Contractor shall promptly, and before such conditions are disturbed, give a written notice to the Contracting Officer of: (1) subsurface or latent physical conditions at the site which differ materially from those indicated in this contract, or

(2) unknown physical conditions at the site of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in this contract.

(b) The Contracting Officer shall investigate the site conditions promptly after receiving the written notice. If the conditions do materially so differ and cause an increase or decrease in the Contractor's cost of, or of the time required for, performing any part of the work under this contract, whether or not changed as a result of the conditions, an equitable adjustment shall be made under this clause and the contract modified in writing accordingly.

(c) No request by the Contractor for an equitable adjustment to the contract under this clause shall be allowed unless the Contractor has given the written notice required; provided, however, the time prescribed in (a) above for giving written notice may be extended by the Contracting Officer.

(d) No request by the Contractor for an equitable adjustment to the contract for differing site conditions shall be allowed if made after final payment under this contract.

The 1987 edition of the American Institute of Architects (AIA) Document A201, General Conditions for the Contract for Construction, contains a differing site conditions clause similar to

the federal model.

Having a differing site conditions clause in the contract does not exempt the contractor from inspecting the site. Courts have found an implied obligation that a contractor make at least a minimal inspection of the site to familiarize itself with the property. Most contracts today include an express “site inspection clause” obligating the contractor to inspect and familiarize itself with the conditions at the site. The AIA A201 General Conditions has such an inspection provision, and directs the contractor to verify field conditions and measurements before commencing construction.

When the contract has a site inspection clause, and the contractor unreasonably fails to inspect the site, the contractor may be foreclosed from invoking the terms of the differing site conditions clause. If, however, the contractor makes a reasonable inspection of the site, yet fails to discover the differing site condition, the two clauses may conflict.

The courts have resolved the conflict by applying a standard of reasonableness. The contractor is obligated to discover conditions apparent through a reasonable investigation. The contractor is not obligated to discover hidden conditions, which do not surface through a reasonable investigation. The contractor is also not required to perform burdensome, extensive, or detailed tests or analyses. If the investigation is constrained by weather conditions, site conditions, or time in the contracting process, the contractor will be only required to perform an investigation that is reasonable under the circumstances.

A disclaimer or reliance clause may limit the effectiveness of a differing site conditions clause. These clauses typically state that information received from the project owner is provided solely for informational purposes and that the owner does not warrant the accuracy or sufficiency of the information provided. The objective of the provision is to render unreasonable any reliance

by the contractor on owner-provided information which characterizes the condition of the property.

Courts have reached a variety of results on the effect of disclaimer provisions. Some courts have held that a disclaimer effectively precluded a contractor from arguing that reliance on the owner-provided information was reasonable. See, *J.E. Brenneman Co. v. Commonwealth Department of Transportation*, 56 Pa. 210, 424 A.2d 592 (1981); *Zurn Engineers v. State of California*, 69 Cal.App.3d 798, 138 Cal.Rptr. 478, *cert. denied*, 434 U.S. 985 (1977). In order to be effective, such clauses should provide that the information was not warranted and that the contractor has not relied on the information. These provisions are most effective when combined with a site inspection clause.

In *Brown-McKee, Inc. v. Western Beep, Inc.*, 538 S.W.2d 840 (Tex.Civ.App. -- Amarillo 1976, writ ref'd n.r.e.), the contractor had no notice of a hard rock formation immediately below the ground surface. However, the contractor's claim for a differing site condition was denied due to a broad disclaimer of subsurface conditions in the contract. The court held that with that clause, the contractor would have to prove deception or bad faith on the part of the owner or show that the owner had withheld material information that it had a duty to disclose.

In *Millgard Corp. V. McKee/Mays*, 49 F.3d 1070 (5th Cir. 1995), the contract disclaimed a particular soil borings report. Although the contract also contained a differing site conditions provision, the court held that the subcontractor could not rely on the soil borings report to support its claim since the report had been specifically disclaimed.

Other courts have held that disclaimer clauses do not preclude reliance on information received from the owner. The situations in which courts have allowed contractors to rely on information received from the owner despite a disclaimer clause may be grouped in three categories.

First, cases hold that reliance was permissible because the contractor performed a reasonable investigation that confirmed or supported the information received from the owner. Second, cases hold that reliance was justified because the owner intended that the contractor rely on the information in preparing a bid. Third, cases hold that reliance was justified because the circumstances did not allow sufficient time for the contractor to conduct an adequate independent investigation. The cumulative effect of these limitations is that a contractor may rely on information received from the owner except when relatively simple inquiries might have revealed contrary conditions.

4. Indemnity

If the owner requires indemnity for its own negligent acts, the owner cannot subtly demand it. Indemnity for one's own negligence must be expressly stated in the contract. In *Ethyl Corp. v. Daniel Construction Co.*, 725 S.W.2d 705 (Tex. 1987), the Texas Supreme Court announced the express negligence doctrine to avoid confusion in the interpretation and enforcement of indemnity provisions. Unless the owner 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 AIA language like ¶3.18 in the A201 General Conditions will not satisfy the express negligence doctrine, since it does not mention the owner's negligence.

In *Atlantic Richfield Co. v. Petroleum Personnel, Inc.*, 768 S.W.2d 724 (Tex. 1989), the Texas Supreme Court upheld the following language as satisfying the express negligence doctrine:

Contractor [PPI] agrees to hold harmless and unconditionally indemnify COMPANY [ARCO] against and for all liability, cost, expenses, claims and damages which

[ARCO] may at any time suffer or sustain or become liable for any reason of any accidents, damages or injuries either to the persons or property or both, of [PPI], or of the workmen of either party, or of any other parties, or to the property of [ARCO], in any matter arising from the work performed hereunder, including but not limited to any negligent act or omission of [ARCO], its officers, agents or employees.

In *Dresser Industries v. Page Petroleum Co.*, 853 S.W.2d 505 (Tex. 1993), the Supreme 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 all capital letters or contrasting type or color is sufficient.

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 were 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.

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.

5. No Damages for Delay

Ordinarily, the owner is responsible for delays the owner causes to the contractor. For example, 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.

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 was to obtain the rights of way for the work. The parties had planned to do the work in the dry summer months. Because the owner failed to obtain the rights of way before the summer, the contractor had to perform the work in the fall in between rain storms. As a result, the work was performed sporadically as weather permitted and cost significantly more. The contractor did not complete work until three months after the scheduled completion date. The contractor 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 almost \$900,000 in extra costs as a result of the massive number of changes. The contractor successfully sued to recover the extra money. The court reasoned that the owner had caused the delays and increased the costs, and should pay for them.

With a no damages for delay clause, however, the owner can disclaim responsibility for the

contractor's extra costs arising from delays on project. 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 plans and specifications for the project. The large number of changes was later held not to be within the contemplation of the parties when the project began. As a result of all the changes, the contractor incurred \$3 million in extra 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.

However, the contract contained a variation of the no damages for delay clause, which precluded recovery for extra indirect costs for changes and modifications to the contract.

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

CASES INVOLVING DESIGN BUILDERS OR DESIGN BUILD CONCEPTS

Mathis v. RKL Design/Build, 189 S.W.3d 839 (Tex.App. – Houston [1st Dist.] 2006).

A contractor sued a design builder, among others, for negligence seeking damages from fall into hole on homeowner's property. The design builder filed a no-evidence motion for summary judgment. The trial court granted a summary judgment and the contractor appealed. On appeal, the court of appeals held that the design builder did not owe a duty to make property safe; and the doctrine of *res ipsa loquitur* was not available to contractor to establish negligence claim against the design builder.

In his sole point of error, the contractor argued that the trial court erred as a matter of law by granting summary judgment dismissing the design builder from the action. By way of its no-evidence motion for summary judgment and traditional motion for summary judgment, the design builder contended that there was no evidence of duty or proximate cause, and, alternatively, that the contractor could not meet his burden of proving the design builder's negligence or negligence *per se*.

The court of appeals first observed that a cause of action for negligence consists of three essential elements: (1) a legal duty owed by one party to another; (2) a breach of that duty; and (3) damages proximately caused by that breach. *Greater Houston Transp. Co. v. Phillips*, 801 S.W.2d 523, 525 (Tex.1990). Duty is the threshold inquiry in a negligence case. *Id.* The existence of a duty is a question of law for the court to decide based on the specific facts of the case. *Id.* To withstand the design builder's no-evidence summary judgment, the contractor had to establish that some duty was owed to him by the design builder. See *Centeq Realty v. Siegler*, 899 S.W.2d 195, 197

(Tex.1995).

The court observed that an owner or occupier of land has a duty to use reasonable care to keep the premises under his control in a safe condition. *Smith v. Henger*, 226 S.W.2d 425, 431 (Tex.1950). A general contractor on a construction site, who is in control of the premises, is charged with the same duty as is an owner or occupier. *Id.* at 431. The duty to keep the premises in a safe condition may subject the owner, occupier, or general contractor to liability in two situations: (1) those arising from a defect in the premises and (2) those arising from an activity or instrumentality. *Redinger v. Living, Inc.*, 689 S.W.2d 415, 417 (Tex.1985).

The court noted that under certain circumstances, however, even one not in control of the property at the time of the injury may owe a duty to make the premises safe. *Lefmark Mgmt. Co. v. Old*, 946 S.W.2d 52, 54 (Tex.1997). One who agrees to make safe a known, dangerous condition of real property owes a duty of due care. *City of Denton v. Page*, 701 S.W.2d 831, 835 (Tex.1986). A person who creates a dangerous condition owes the same duty. *Id.* (citing *Strakos v. Gehring*, 360 S.W.2d 787 (Tex.1962)).

The court noted that the contractor contended that the design builder exercised control of the property at issue because the design builder requested bids and gave keys to the general contractors on the owner's behalf. The contractor relied on *Smith v. Henger* to show that the design builder had control of the property at issue. See *Smith*, 226 S.W.2d at 431.

In *Smith*, the Texas Supreme Court held that, under the terms of the contract and the evidence showing actual control, the coordinator had a legal duty to use reasonable care to furnish a safe place to work for the employees of other contractors. *Id.* at 430. The court looked at the coordinator's conduct and provisions of the contract to determine that the coordinator had assumed the usual duties

and responsibilities of a general contractor. *Id.* at 430-31. The evidence in *Smith* showed that the written contract between the property owner and the coordinator expressly provided that the coordinator would "have exclusive control of the supervision and coordination of the construction of said building...." *Id.* The coordinator also testified that it was his duty to see that everything was safe and that the premises to which his control extended included the place where the subcontractor's employee was hurt. *Id.*

The court contrasted the *Smith* case to this one by stating that there was no evidence that, by conduct or under contract, the design builder had assumed the usual duties and responsibilities of a general contractor. See *id.* at 430-31. The court stated that the evidence did not show that the design builder had actual control, but, rather, that the design builder was not an owner and did not occupy the property at issue where the contractor was injured. The court noted that the owner had hired the design builder to prepare a set of architectural plans and to obtain construction bids from general contractors. The design builder conclusively proved that it did not create or cover the hole into which the contractor fell. In his affidavit, the contractor acknowledged that he was invited and accompanied onto the property by an entity other than the design builder, and that the unmarked, concealed hole into which he fell was left behind by another contractor which had performed stabilization work on the property. The court observed that the design builder's involvement was limited to requesting bids from various general contractors and providing keys to them, with the owner's permission, so that they could complete their bids. The court noted that the contractor provided no evidence that the design builder had owned, occupied, or created the dangerous condition or agreed to make it safe, and the contractor provided less than a scintilla of evidence that the design builder actually controlled the property on the date of his accident. See *King Ranch*, 118

S.W.3d at 751. The court concluded that the contractor failed to carry his summary judgment burden of establishing that the design builder owed a duty to him to control the premises. See Lefmark Mgmt. Co., 946 S.W.2d at 54; Page, 701 S.W.2d at 835; Smith, 226 S.W.2d at 431.

C. Res Ipsa Loquitur

The contractor also claimed that the trial court erred in granting summary judgment because the design builder did not prove that it was not negligent. The contractor argued that one of the defendants in the underlying case must have been negligent because there is no other explanation for the "dangerous hole" on the property. The Contractor contended that he can rely on the doctrine of res ipsa loquitur to establish the negligence of the design builder.

The court observed that the doctrine of res ipsa loquitur is Latin for "the thing speaks for itself." *Marathon Oil Co. v. Sterner*, 632 S.W.2d 571, 573 (Tex.1982). To establish a claim by res ipsa loquitur, a plaintiff must prove (1) an accident of this character does not ordinarily occur in the absence of negligence and (2) the instrument that caused the accident was under the exclusive management and control of the defendant. *Id.*; *Rogers v. Duke*, 766 S.W.2d 547, 548 (Tex.App.-Houston [1st Dist.] 1989, no writ).

The first factor is satisfied in this case, the second is not. The doctrine of res ipsa loquitur is not available to fix responsibility when any one of multiple defendants, wholly independent of each other, might have been responsible for the injury. See *Esco Oil & Gas, Inc. v. Sooner Pipe & Supply Corp.*, 962 S.W.2d 193, 195 (Tex.App.-Houston [1st Dist.] 1998, pet. denied). In contrast, the doctrine can be used to fix responsibility against multiple defendants when they had joint control of the instrumentality causing the injury. See *Bond v. Otis Elevator Co.*, 388 S.W.2d 681, 685 (Tex.1965) (holding that res ipsa was applicable against landlord and elevator company that had joint

control of elevator). Here, the court observed, the design builder did not have joint control with the other defendants over the "dangerous hole."

The appellate court concluded that the trial court did not err in rendering summary judgment for this reason as well.

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Hirschfeld Steel Co. v. Kellogg Brown & Root, Inc., 210 S.W.3d 272 (Tex.App. – Houston [14th Dist.] 2006).

The design builder of a roofing system for Minute Maid Park in Houston, Texas, contended that the ten year warranty for its roof was voided by the owner's lack of maintenance on the roof, and sued for a declaratory judgment to that effect, requesting relief from further obligation concerning the roof. The design builder contended that the owner had failed to undertake contractual obligations to perform maintenance on the roof, and without such maintenance, the design builder's warranty duties were voided. The trial court granted the owner a summary judgment and dismissed the request for declaratory judgment. On appeal, the court reviewed whether the owner's contractual maintenance obligation was a condition precedent to the design builder's warranty duty. The court stated that to determine whether a condition precedent exists, the intention of the parties must be ascertained, and that can be done only by looking at the entire contract. *Criswell v. European Crossroads Shopping Ctr., Ltd.*, 792 S.W.2d 945, 948 (Tex.1990). To make performance specifically conditional, a term such as "if," "provided that," "on condition that," or some similar phrase of conditional language normally must be included. *Id.* If no such language is used, the terms typically will be construed as a covenant in order to prevent a forfeiture. *Id.* Though there is no requirement that such phrases be utilized, their absence is probative of the parties' intention that a promise be

made, rather than a condition imposed. *Id.* In construing a contract, forfeiture by finding a condition precedent is to be avoided when another reasonable reading of the contract is possible. *Id.* When the intent of the parties is doubtful or when a condition would impose an absurd or impossible result, the agreement will be interpreted as creating a covenant rather than a condition. *Id.* Because of their harshness in operation, conditions are not favored in the law. *Id.*

The court then found that there was no language in the contract stating that there will be a ten-year warranty from Hirschfeld "if," "provided that," or "on condition that" the written maintenance program is followed. The court also found that there was no contract language stating that nonperformance of the maintenance program would void the warranty. The court observed that the term "condition" can mean a condition precedent, but it also can be used more generally to mean a term or provision in a contract that is not a condition precedent, citing BLACK'S LAW DICTIONARY 312-13 (8th ed.2004) (defining condition as "a future and uncertain event on which the existence or extent of an obligation or liability depends" and also as "a term, provision, or clause in a contract").

After considering the entire contract at issue, the court held that the performance of the written maintenance plan was not a condition precedent to the existence of Hirschfeld's ten-year warranty. See *Criswell*, 792 S.W.2d at 948-49 (holding that contract language did not make sale of the property on a condominium basis a condition precedent to plaintiff's entitlement to compensation); *Sturges v. System Parking, Inc.*, 834 S.W.2d 472, 474 (Tex.App.-Houston [14th Dist.] 1992, writ *dism'd by agr.*) (concluding there was no condition precedent under contract as a matter of law). The court concluded that the trial court did not err in granting the traditional motions for summary judgment filed by the owner and general contractor and in dismissing with prejudice

Hirschfeld's declaratory-judgment claims regarding the ten-year warranty.

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McKee v. Wilson, 174 S.W.3d 842 (Tex.App. – Waco 2005).

This case involved a design built home, and whether the design builder was entitled to a mechanic's lien on the home to secure the owners' lack of payment.

Prior to July 2001, the McKees lived in their home on Main Street in Waxahachie, Texas, ("Main Street property"). In July, 2001, the McKees orally agreed to have Wilson help design and to build the entire shell of a Victorian-style home based in part on the television show "The Munsters." In October, 2001, a "New Home Contract" and a "Mechanic's Lien Contract" were signed by the McKees and Wilson. Construction of the Munster Home began in November, 2001. During construction, problems arose between the McKees and Wilson regarding the work being done and alleged unauthorized bank draws. It was disputed whether Wilson walked off the project or whether the McKees told Wilson not to return to the project. Wilson ceased working on the Munster Home in February or March, 2002, at which time the shell was almost done except for the roofing and front door, which the McKees completed later. In July, 2002, the McKees sold their Main Street property and began living in the Munster Home. In October, 2002, Wilson filed a mechanic's lien against the McKees' Munster Home property, asserting that the McKees owed him money. The trial court found this lien valid and ordered foreclosure to satisfy part of the judgment.

The appellate court observed that a family is not entitled to two homesteads at the same time.

TEX. CONST., art. XVI, § 51; *Silvers v. Welch*, 127 Tex. 58, 91 S.W.2d 686, 687 (1936); *Achilles v. Willis*, 81 Tex. 169, 16 S.W. 746, 746 (1891). The court stated that a homestead once established is presumed to continue until there is proof it has been abandoned. *Norman v. First Bank*

and Trust, Bryan, 557 S.W.2d 797, 801 (Tex.Civ.App.-Houston [1st Dist.] 1977, writ ref'd. n.r.e.); Gill v. Quinn, 613 S.W.2d 324, 326 (Tex.Civ.App.-Eastland 1981, no writ). The court observed that to establish abandonment of a prior homestead, there must be evidence of an intent not to return to the previous homestead and an intent not to claim a homestead exemption on such property. Rancho Oil Co. v. Powell, 142 Tex. 63, 175 S.W.2d 960, 963 (1943); Burkhardt v. Lieberman, 138 Tex. 409, 159 S.W.2d 847, 852 (1942). Intention alone is not sufficient to constitute abandonment; overt acts of preparation consistent with such intention are required. Cheswick v. Freeman, 155 Tex. 372, 287 S.W.2d 171, 173 (1956).

The court noted that where no homestead dedicated by actual occupancy exists, effect may be given to ownership, intention and preparation to use for a home; however, if a homestead already exists, it cannot be abandoned while actually being used as the home of a family, and at the same time, acquire another homestead by intention at sometime in the future to use this other property as a homestead, even if there is preparation for such use. See *Towery v. Plainview Bldg. & Loan Ass'n*, 99 S.W.2d 1039, 1041 (Tex.Civ.App.-Amarillo 1936, writ ref'd); *Pierce v. Langston*, 193 S.W. 745, 747 (Tex.Civ.App.-Austin 1917, no writ).

In *Towery*, a husband and wife had established homestead rights on their Central Park property long prior to the summer of 1928, and they continued to occupy this property as their homestead until August, 1929, which is the date they moved to their Alabama property. *Towery*, 99 S.W.2d at 1041. They entered into a written agreement with a building contractor in May, 1929, to build a new homestead on their Alabama property. *Id.* The court held that the husband and wife had not acquired homestead rights in the Alabama property at the time of the execution of the building contract and the erection of the building thereunder; thus, whether the written contract with

the builder was invalid due to labor and materials being provided prior to the execution of the contract were irrelevant. *Id.* In *Kendall Builders, Inc. v. Chesson*, when considering whether a property was a homestead for purposes of a mechanic's lien, the court looked at the time the property owners entered into the construction contract with the builder. *Kendall Builders, Inc. v. Chesson*, 149 S.W.3d 796, 809 (Tex.App.-Austin 2004, pet. denied).

To fix a lien on a homestead, a written contract is required between the owner and the builder. TEX. PROP.CODE ANN. § 53.254 (Vernon Supp.2004-05).

The court stated that here, the trial court found a valid statutory mechanic's lien. The McKees' only argument is that the mechanic's lien is invalid due to non-compliance with section 53.254 because they did not enter into a written agreement with Wilson. They argue that the court should look at the status of the property on the date the lien was filed, at which time the Munster Home property was the McKees' homestead.

Wilson argued that the court should look at the date of the construction agreement to determine the status of the property. He argued that when they made an oral agreement for him to help design and build the shell of the Munster Home, the McKees were occupying their Main Street property as their homestead.

The court observed that unless the record showed to the contrary, every reasonable presumption must be indulged in favor of the judgment of the trial court. *Hursey v. Thompson*, 141 Tex. 519, 174 S.W.2d 317, 319 (1943). The court stated that it did not find evidence in the record that the Munster Home property was the McKees' homestead prior to July, 2002, or that the McKees abandoned their Main Street property prior to July, 2002. The court did find evidence in the record that the McKees actually occupied the Main Street property prior to July, 2002. The court held that

it must look at the time of the construction agreements to determine the homestead status of the Munster Home property. See *Towery*, 99 S.W.2d at 1041; see also *Kendall Builders*, 149 S.W.3d at 809. The court noted that the oral agreement was in July, 2001, and the written agreement was in October, 2001. At these times, the McKees had not abandoned their Main Street property and had not established the Munster Home property as their homestead. Thus, the court found it irrelevant whether Wilson complied with section 53.254 for purposes of the statutory mechanic's lien found in the judgment against the Munster Home property.

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Tractebel Energy Marketing, Inc. v. E.I. DuPont De Nemours and Co., 118 S.W.3d 60 (Tex.App. – Houston [14th Dist.] 2003).

Tractebel Power, Inc. ("TPI"), sued DuPont to recover money for DuPont's alleged breach of a contract for Du Pont to sell pollution credits to TPI. TPI through an agent had contracted with DuPont to buy 1,000 tons of credits for \$1 million on March 10, 1998. Shortly thereafter, the New Jersey Department of Environmental Protection ("NJDEP") revoked the credits, citing new regulations. Deprived of its credits, DuPont refused to perform. DuPont sued NJDEP for revoking the credits, and TPI sued DuPont. DuPont later abandoned its suit. At trial, a jury found DuPont breached the contract and caused TPI damages of \$1.2 million, but excused the breach due to commercial impracticability. However, the definition of impracticability given to the jury excluded two critical elements, neither of which was supported by any evidence at trial. Finding no evidence to support the only issue found in DuPont's favor, we reverse the judgment below and remand for judgment in accordance with the remainder of the jury's verdict.

TPI designs and builds power plants. EPA regulations require certain new sources of air

emissions (like power plants) to offset anticipated increases in overall emissions by purchasing emission reduction credits from existing plants. Existing plants create these credits by installing better technology or shutting down operations. In connection with its plans to build a power plant in New England, TPI retained an agent to find and purchase the credits it would need.

DuPont earned 7,649 tons per year of NOx emission credits in 1983 by reducing emissions from its Repauno Plant in New Jersey. New Jersey law provides that future regulations can reduce or eliminate these credits at any time, a fact confirmed in a letter to DuPont from the New Jersey Department of Environmental Protection confirming the credits.

In 1994, DuPont's credits were cut almost in half, with the NJDEP again issuing the same warning of potential future reductions.

At trial, a jury found a contract had been formed, DuPont had repudiated it, and TPI had incurred \$1.2 million in damages. The jury rejected DuPont's defenses that performance was excused by mutual mistake, unilateral mistake, or impossibility, but agreed with its defense that performance was excused due to commercial impracticability. On that basis, the trial court rendered judgment in DuPont's favor. TPI appealed, and the court of appeals had to review the law of impracticability in Texas.

-Impracticability in Texas-

TPI argued that commercial impracticability was not recognized as a defense in Texas except in the context of the sale of goods. The court stated that although Texas courts have rarely used that name, they have accepted the defensive doctrine under aliases.

The court observed that section 261 of the Restatement (Second) of Contracts defined impracticability in the following terms:

§ 261. Discharge by Supervening Impracticability.

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

The court noted that in three following sections, the Restatement addressed the general contexts in which the defense has been accepted: (1) the death or incapacity of a person necessary for performance, (2) the destruction or deterioration of a thing necessary for performance, and (3) prevention by governmental regulation.

The court observed that Texas courts have excused performance in each of these situations (though not using the term impracticability). And in its most recent pronouncement on the subject, the Supreme Court relied on sections 261 and 264 of the Restatement in setting out the proper elements of the defense. Although the Supreme Court referred to the defense as "impossibility" rather than impracticability, it is clear the Court approved the substance of the Restatement sections regardless of the name applied to the defense. Thus, the court of appeals found the doctrine of commercial impracticability as defined in the Restatement does exist in Texas.

TPI also contended on appeal that the trial court should have determined impracticability as a matter of law rather than submitting the question to the jury. The court observed that various states appear to disagree on the point. But in Texas, defenses to breach of contract are generally considered questions for the jury unless the facts are uncontested. Here, the very existence of a contract was hotly disputed, as were most of the elements required by the Restatement to establish

impracticability. Under these circumstances, the court held that the trial court properly submitted the impracticability question to the jury.

-Impracticability and Basic Assumptions-

In its remaining issues, TPI challenged the sufficiency of the evidence to support the defense. The court noted that generally, impracticability excuses a party's breach of contract when the contract itself doesn't provide an escape clause and the doctrine's other requirements are satisfied. Because courts cannot simply rewrite the parties' contract, the excuse is limited to circumstances in which both parties held a basic (though unstated) assumption about the contract that proves untrue. This "basic assumption" requirement is reflected in the Restatement, the Uniform Commercial Code, and federal common law.

In the Texas cases recognizing the defense, the "basic assumption" of the parties is relatively obvious. In a contract for personal services, the death or incapacity of the person involved makes the contract impracticable for obvious reasons. Similarly, a contract to lease or insure a building is rendered impracticable if the building is destroyed. A change in the law that makes performance illegal also renders it impracticable. In each of these circumstances, it takes little imagination to see that both contracting parties entertained a basic assumption about the contract that proved untrue.

The court found that in this case, DuPont clearly had its own credits in mind when entering the contract, but for this to be a basic assumption of the contract there must be evidence that TPI did as well. The contract here did not specify the source or ownership of the credits being sold. Although parties may understand a specific thing is needed for performance based on prior dealings, there were no such dealings here.

Instead, the court found that the evidence indicated a broker made the initial contact between

the parties, but to protect his own position, did not disclose to either the identity of the other until a deal was struck. Thus, TPI did not even know it was contracting with DuPont until the agreement was made, and could not have understood that continued validity of the credits was a basic assumption of the agreement.

DuPont contended that the broker was acting as TPI's agent in the transaction, so his knowledge that DuPont was selling its own credits must be attributed to TPI. But this is not an invariable rule, as the Court has previously held:

If a broker, under his contract with his principal, is charged with no responsibility and is not obligated to exercise any discretion, but his duty consists merely of bringing the parties together so that, between themselves, they may negotiate a sale, and the sale is made in that manner, the broker is considered a mere "middleman" and is not necessarily the "agent" of either party.

The court declared that there were good reasons here not to attribute the broker's knowledge about DuPont to TPI, as it is undisputed the broker kept the parties' identities confidential to protect his own position in the negotiations. But even assuming TPI knew DuPont was selling its own credits, this does not mean TPI understood that to be a basic assumption of the contract. According to the Restatement, the defense of impracticability does not apply when both parties know of the intended source if it is not a basic assumption of both parties that there will be no contract if that source fails. This point is repeated in several illustrations:

- a seller's knowledge of a buyer's intended source of funds is not a basic assumption of the contract unless the seller understands there will be no sale if that source fails.
- a farmer's agreement to sell milk under a contract that does not specify the source is not discharged if the farmer's herd is subsequently destroyed due to disease.
- a manufacturer's contract to sell a product it makes is not discharged by the destruction of its factory so long as product meeting the contract is available elsewhere on the market.

The court noted that in each case, one party's assumption about the source of supply--and the other party's knowledge of that assumption--is not enough to excuse performance if alternative sources of supply are still available to fulfill the contract.

In this case, the court noted that credits from another source would have fulfilled the terms of the contract, and would have served TPI's purposes just as well. The court held that there was no evidence TPI contracted on the assumption that DuPont's credits and only those credits were the subject of the contract.

The court found that it was not surprising that the jury reached a contrary conclusion, because the instruction they received did not include this basic-assumption requirement. Generally, when a portion of the Restatement has been adopted by Texas courts, a jury question must incorporate the elements required by the Restatement. Both parties pointed out the omission and objected to it; the record does not reflect why this critical element was excluded.

Because TPI objected to the charge, the court measured the legal sufficiency of the evidence by the charge the trial court should have given. Applying that standard, the court held that there was no evidence the continued existence of DuPont's credits was a basic assumption of both parties in making this agreement, and the trial court erred in submitting impracticability to the jury.

-Impracticability and Reasonable Efforts-

The basic-assumption element was not the only one omitted from the definition of impracticability given to the jury. The Restatement also provides a party claiming the defense must use reasonable efforts to surmount the obstacle to performance:

[A] party is expected to use reasonable efforts to surmount obstacles to performance
..., and a performance is impracticable only if it is so in spite of such efforts.

An illustration makes clear that a party blaming governmental regulations for nonperformance must pursue all remedies reasonably available to avoid them:

A contracts to construct and lease to B a gasoline service station. A valid zoning ordinance is subsequently enacted forbidding the construction of such a station but permitting variances in appropriate cases. [A] makes no effort to obtain a variance, although variances have been granted in similar cases, and fails to construct the station. A's performance has not been made impracticable. A's duty to construct is

not discharged, and A is liable to B for breach of contract.

TPI argued that DuPont failed to use reasonable efforts by failing to pursue an appeal of the NJDEP decision to cancel its credits. The NJDEP based its cancellation on regulations requiring DuPont to lower emissions effective as of June 30, 1998 (at the earliest) and June 30, 1999 (at the latest). DuPont submitted a new emissions control plan that was adopted on August 15, 1997. On March 30, 1998, the NJDEP decided the credits were eliminated as of the adoption date of DuPont's plan (seven months before the credit sale) instead of the effective date of the regulations (three months after the sale).

Several DuPont witnesses (including a former NJDEP executive) testified the cancellation was improper and unprecedented, that cancellation of credits before the effective date of a new and more restrictive regulation had never occurred before or since. Indeed, DuPont filed a lawsuit challenging the cancellation, but later voluntarily dismissed it. DuPont witnesses explained the appeal was dismissed because DuPont did not believe it could win, at least not in time to effectuate the contract. When pressed for the basis of this opinion, DuPont claimed the attorney-client privilege.

The Restatement recognizes that even an invalid government regulation may make performance impracticable, but again requires a party seeking discharge to use reasonable efforts to avoid its application. The court found that here, DuPont presented opinions that its efforts were reasonable, but no evidence to that effect. Both at trial and on appeal, DuPont presented neither evidence nor argument that it would have lost on the merits; to the contrary, it has continued to insist the NJDEP acted improperly. The court also noted that there was no evidence or explanation

why DuPont could not have obtained an order approving the credit sale retroactive to the date of denial.

The court stated that DuPont's explanation for the voluntary dismissal of its appeal cannot be enough-if all that is required to show reasonable effort is evidence that "on advice of counsel we decided to do nothing," then no effort would be required beyond a conversation with an attorney. DuPont was not necessarily required to waive its attorney-client privilege, but it was required to explain why abandoning the appeal was a reasonable thing to do. As it never did so, the court held that there was no evidence DuPont took reasonable measures to challenge the NJDEP revocation, and thus again could not rely on the doctrine of impracticability.

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Centex Homes v. Buecher, 95 S.W.3d 266 (Tex. 2002).

The issue in this case was whether a homebuilder may disclaim the implied warranties of habitability and good and workmanlike construction that accompany a new home sale. The sales contract here provided that the builder's express limited warranty replaced all other warranties, including these two implied warranties. The court of appeals held that the implied warranties of habitability and good and workmanlike construction could not be waived, and reversed the trial court's judgment and remanded the homeowners' claims for further proceedings. The Texas Supreme Court agreed with the court of appeals that the implied warranty of habitability could not be waived except under limited circumstances not implicated here. The court disagreed, however, that the implied warranty of good and workmanlike construction could not be disclaimed. The court held that when the parties' agreement sufficiently described the manner, performance or quality of

construction, the express agreement may supersede the implied warranty of good workmanship.

The facts indicated that Michael Buecher and other homeowners purchased new homes built by Centex Homes or Centex Real Estate Corporation doing business as Centex Homes. Each homeowner signed a standard form sales agreement prepared by Centex. The homeowners alleged that the agreement contained a one-year limited express warranty in lieu of and waiving the implied warranties of habitability and good and workmanlike construction. Specifically, the disclaimer provision provided:

At closing Seller will deliver to Purchaser, Seller's standard form of homeowner's Limited Home Warranty against defects in workmanship and materials, a copy of which is available to Purchaser. PURCHASER AGREES TO ACCEPT SAID HOMEOWNER'S WARRANTY AT CLOSING IN LIEU OF ALL OTHER WARRANTIES, WHATSOEVER, WHETHER EXPRESSED OR IMPLIED BY LAW, AND INCLUDING BUT NOT LIMITED TO THE IMPLIED WARRANTIES OF GOOD WORKMANLIKE CONSTRUCTION AND HABITABILITY. PURCHASER ACKNOWLEDGES AND AGREES THAT SELLER IS RELYING ON THIS WAIVER AND WOULD NOT SELL THE PROPERTY TO PURCHASER WITHOUT THIS WAIVER. Purchaser's initials in the margin indicate their approval of this section 8.

(Emphasis in original.)

After Buecher and the other plaintiffs purchased their homes, they sued Centex alleging

fraud, misrepresentation, negligence, and violation of the of the Texas Deceptive Trade Practices-Consumer Protection Act ("DTPA") in connection with the construction and sale of their new homes. The homeowners also sought to certify a class action against Centex, seeking (1) an injunction to prevent Centex from asserting that the implied warranties of habitability and good and workmanlike construction had been waived by the provisions in its sales contracts; (2) an injunction prohibiting Centex from asserting to any homeowner or subsequent purchaser that it had no liability for construction defects beyond the period set forth in the express warranty it gave in lieu of implied warranties; (3) a declaration that the disclaimer provision is unenforceable as a matter of law; and (4) notification to all purchasers and subsequent purchasers within the putative class that Centex's waiver of implied warranties is void and unenforceable.

In *Humber v. Morton*, 426 S.W.2d 554, 555 (Tex.1968), the Texas Supreme Court recognized that a builder of a new home impliedly warrants that the residence is constructed in a good and workmanlike manner and is suitable for human habitation. In replacing caveat emptor with these two implied warranties, we noted the significance of a new home purchase for most buyers and the difficulty of discovering or guarding against latent defects in construction:

The old rule of caveat emptor does not satisfy the demands of justice in [the sale of new homes]. The purchase of a home is not an everyday transaction for the average family, and in many instances is the most important transaction of a lifetime. To apply the rule of caveat emptor to an inexperienced buyer, and in favor of a builder who is daily engaged in the business of building and selling houses, is manifestly a denial of justice.

The homeowners responded that *Robichaux* is no longer the law in Texas because it was overruled in *Melody Home Manufacturing Co. v. Barnes*, 741 S.W.2d 349, 355 (Tex.1987). *Melody Home* recognized for the first time an implied warranty of good workmanship in the repair or modification of tangible goods or property. *Id.* at 354. The Court further announced as a matter of public policy that this implied warranty for repair services could not be waived or disclaimed. *Id.* at 355. Referencing the dissent in *Robichaux*, the Court noted the incongruity of requiring the creation of an implied warranty and yet permitting its elimination "by a pre-printed standard form disclaimer or an unintelligible merger clause." *Id.* The Court suggested that such disclaimers should not be allowed because they encouraged shoddy workmanship, thus circumventing the consumer's reasonable expectations that the job would be performed with reasonable skill. *Id.* At the end of this discussion, the Court purported to overrule *Robichaux* "[t]o the extent that it conflicts with this opinion." *Id.* The meaning and scope of this statement have proven elusive because it is unclear to what extent *Robichaux* and *Melody Home* actually conflict.

The Court declared that factually, the two cases do not conflict at all. The court stated that *Melody Home* does not apply the *Humber* warranties at issue in *Robichaux*. The court observed that the implied warranty of good and workmanlike construction in *Humber* and the implied warranty of good and workmanlike repair services in *Melody Home* are very similar, and yet the two cases diverge drastically on appropriate public policy in this area. The court noted that *Melody Home* rejects *Robichaux's* notion that the implied warranty of good workmanship may freely be disclaimed as long as that intention is clearly expressed. *Id.* Because the two cases are factually distinguishable, yet legally antithetical, other authorities have had trouble determining how much of *Robichaux* survives *Melody Home*.

In *Robichaux*, the alleged defect in the buyers' new home was a sagging roof. The trial court rendered judgment for the buyers on jury findings that the builder "had failed to construct the roof in a good workmanlike manner and that the house was not merchantable at the time of completion." *Robichaux*, 643 S.W.2d at 392. The court of appeals affirmed.

The Supreme Court noted that it disagreed and rendered judgment for the builder. *Id.* The court held that the implied "warranty of merchantability" was a sales warranty under the Texas Uniform Commercial Code, which did not apply to the sale of a house. *Id.* at 394. Then, in reviewing the jury finding that the roof was not constructed in a good and workmanlike manner, the court conflated the *Humber* warranties of good workmanship and habitability, referring to the warranty at issue as both the "implied warranty of fitness" and the "implied warranty of habitability." *Id.* at 393. In fact, the implied warranty of habitability was not at issue in the case because the jury had only found a breach of the implied warranty of good and workmanlike performance. See *id.* at 392. The Court nevertheless concluded that language in the sales documents that there were no "warranties, express or implied, in addition to said written instruments" was sufficiently clear to effectively disclaim the implied warranty of habitability. *Id.* at 393.

The court concluded that the implied warranty of good workmanship focuses on the builder's conduct, while the implied warranty of habitability focuses on the state of the completed structure. The court observed that through the implied warranty of good workmanship, the common law recognizes that a new home builder should perform with at least a minimal standard of care. The court stated that this implied warranty requires the builder to construct the home in the same manner as would a generally proficient builder engaged in similar work and performing under similar circumstances, citing *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349, 354-55 (Tex.1987). The

implied warranty of good workmanship serves as a "gap-filler" or "default warranty"; it applies unless and until the parties express a contrary intention. Thus, the implied warranty of good workmanship attaches to a new home sale if the parties' agreement does not provide how the builder or the structure is to perform.

The court contrasted the implied warranty of habitability, which on the other hand, looks only to the finished product:

[T]he implied warranty of habitability is a result oriented concept based upon specific public policy considerations. These include the propriety of shifting the costs of defective construction from consumers to builders who are presumed better able to absorb such costs; the nature of the transaction which involves the purchase of a manufactured product, a house; the buyer's inferior bargaining position; the foreseeable risk of harm resulting from defects to consumers; consumer difficulty in ascertaining defective conditions; and justifiable reliance by consumers on a builder's expertise and implied representations.

Davis, 72 NEB. L.REV. at 1019 (footnotes omitted). The court stated that this implied warranty is more limited in scope, protecting the purchaser only from those defects that undermine the very basis of the bargain. *Id.* at 1015. It requires the builder to provide a house that is safe, sanitary, and otherwise fit for human habitation. *Kamarath*, 568 S.W.2d at 660. In other words, this implied warranty only protects new home buyers from conditions that are so defective that the property is unsuitable for its intended use as a home. As compared to the warranty of good workmanship, "the

warranty of habitability represents a form of strict liability since the adequacy of the completed structure and not the manner of performance by the builder governs liability." Davis, 72 NEB. L.REV. at 1015 (1993) (footnotes omitted).

The court stated that these two implied warranties parallel one another, and they may overlap. For example, a builder's inferior workmanship could compromise the structure and cause the home to be unsafe. But a builder's failure to perform good workmanship is actionable even when the outcome does not impair habitability. Evans, 689 S.W.2d at 400. Similarly, a home could be well constructed and yet unfit for human habitation if, for example, a builder constructed a home with good workmanship but on a toxic waste site. The court admitted that many courts, including itself, have not consistently recognized these distinctions.

In *Robichaux*, the court failed to distinguish between habitability and good workmanship, conflating the two implied warranties and concluding that they could be disclaimed with clear language. *Robichaux*, 643 S.W.2d at 393. And although habitability was not at issue, the court indiscriminately swept it into our analysis. That analysis further omitted any discussion of the public policy considerations that prompted the creation of the *Humber* warranties in the first place. See *Humber*, 426 S.W.2d at 561 (rejecting rule of caveat emptor in new home sales); see also 17 RICHARD A. LORD, WILLISTON ON CONTRACTS § 50:30(4th ed.2000) (noting that the modern trend rejects rule of caveat emptor in new home sales).

The Supreme Court stated that it created the *Humber* implied warranties to protect the average home buyer who lacks the ability and expertise to discover defects in a new house. *Humber*, 426 S.W.2d at 561. Such buyer generally expects to receive a house that is structurally sound, habitable and free of hidden defects, and these implied warranties serve to protect the buyer's

reasonable expectations. While the parties are free to define for themselves the quality of workmanship, there is generally no substitute for habitability. The implied warranty of habitability is thus an essential part of a new home sale.

The court observed that the implied warranty of good workmanship, however, defines the level of performance expected when the parties fail to make express provision in their contract. It functions as a gap-filler whose purpose is to supply terms that are omitted from but necessary to the contract's performance, citing the RESTATEMENT (SECOND) CONTRACTS § 204 (1981) (Supplying an Omitted Essential Term). As a gap-filler, the parties' agreement may supersede the implied standard for workmanship, but the agreement cannot simply disclaim it. See generally *Lenape Res. Corp. v. Tenn. Gas Pipeline Co.*, 925 S.W.2d 565, 570 (Tex.1996) (interpreting UCC gap-filler).

The court concluded that the implied warranty of good workmanship may be disclaimed by the parties when their agreement provides for the manner, performance or quality of the desired construction. The court further held that the warranty of habitability may not be disclaimed generally. This latter implied warranty, however, only extends to defects that render the property so defective that it is unsuitable for its intended use as a home. Further, the implied warranty of habitability extends only to latent defects. It does not include defects, even substantial ones, that are known by or expressly disclosed to the buyer.