Law of Construction Administration

To determine the law applicable to a particular contract, the first place to look is the contract itself. Under Texas law, the contract is the law between the parties. *Thompson v. CPN Partners, L.P.*, 23 S.W.3d 64, 71 (Tex.App. – Austin 2000)("An unambiguous contract must be interpreted by the trial court as a matter of law."). The contract, however, includes not only the contract document itself, but also all that it incorporates by reference. *In re Premont Independent School District*, 225 S.W.3d 329, 334 (Tex.App. – San Antonio 2007)(unsigned arbitration agreement validly incorporated by reference). It matters not whether you have read the contract or the incorporated provisions – all are enforceable just as if you had studied and negotiated them at length. The law presumes that you have read and agreed to the contract, and will hold you to the terms of the agreement. Otherwise, anyone could claim that he or she did not read some damaging portion of a contract and should not be bound by it. See, e.g., Tamez v. Southwestern Motor Transport, Inc., 155 S.W.3d 564, 570 (Tex.App. – San Antonio 2004)("Therefore, even though English was not his first language, we must presume, as a matter of law, that Tamez read and understood the contract, unless he was prevented from doing so by trick or artifice.").

As a design professional, you may have an opportunity to negotiate and dictate at least some portion of the contract documents for a construction project. With a private development, you usually will have more freedom to suggest or recommend the construction documents. Over the course of 120 years, the American Institute of Architects has developed a regime of contract documents which generally favor architects and should be an architect's documents of choice. The AIA documents may be found at the following web site: http://www.aia.org/docs_default

The AIA provisions have the benefit of many court interpretations, which tend to lessen

argument, and increase certainty. The AIA has reacted to court decisions to revise its contract documents to help shield architects from unintended liability and responsibility.

-Defining the Administration Process

-Contract Provisions

The contracts involving the owner, architect, contractor and trade contractors and suppliers set out the responsibilities and duties for a construction project. It is important that the contracts be in writing to lessen argument over scope.

-Owner-Architect

The owner-architect contract should set out the design professional's responsibilities for administration during the construction process. If the design professional does not have construction administration duties, the contract should so state in unequivocal terms. However, the design professional should press for full construction administration duties as savvy construction administration can avoid or resolve adverse consequences from an imprecise design, lack of design clarity, changed conditions, changed regulatory circumstances, and other possible design intent problems. If the owner omits the designer from the construction process, various design issues can arise which cause the owner or contractor to incur significant extra costs. The owner or contractor may seek compensation for the extra costs. But had they consulted the design professional, the designer could likely have resolved the issue at no cost to the owner or contractor.

The owner-architect agreement generally incorporates by reference the general conditions and supplementary conditions of the construction contract, and requires the designer to enforce or administer such conditions.

-Owner-Contractor

The owner-contractor contract usually contains general conditions and sometimes supplementary or other conditions which the architect must administer. Should the architect fail to do so, or to do so properly, the architect could be liable to the owner. The architect often can provide the form of the owner-contractor contract. The architect should encourage the owner to employ the AIA contract documents regime since the AIA documents contain well considered protection for the design professionals.

As one example, say the AIA documents are employed for both the owner-architect and owner-contractor contracts. Say the owner develops a claim which could implicate either a design problem for which the architect must answer or a construction defect by the contractor. The owner has to make a claim against both the architect and contractor to cover its bases. Under the AIA documents, the owner would have to arbitrate with the architect, and in a separate proceeding arbitrate with the contractor. Conceivably, the owner could lose both arbitrations, since in each the respondent would contend that the missing party was responsible for the problem.

-State Tort Law

State law also governs an architect's obligations concerning construction administration. This is especially true for safety issues, as more fully discussed below.

-Determining Who Is Responsible for Administration

Both the owner-architect agreement and the owner-contractor contract should specify the nature and extent of the architect's role in construction administration. This service should be

negotiated and compensated, as it implicates significant legal responsibilities and financial consequences. If the owner decides not to employ the architect for construction services, the owner-architect agreement should specifically indicate that the architect is available for construction administration, but the owner has opted not to employ the architect for such services. The owner-architect agreement should also state that the architect has no responsibility for errors in construction administration since the owner has not involved the architect. If the architect extracts these concessions from the owner, and construction problems arise, the architect will be in a better position to defend itself.

-Identifying Issues in Construction Administration

In no particular order, this paper will examine and discuss various issues that arise during construction administration.

-Payment

The architect plays an important role in the contractor's payment process. The contract documents usually appoint the architect as the point for determining whether the contractor's progress on the project is sufficient to justify a particular amount of payment. Payment is often based on the schedule of values that the contractor submits at the beginning of the project.

In *Bernard Johnson, Inc. v. Continental Constructors, Inc.*, 630 SW2d 365 (TexApp -- Austin 1982), n.r.e.(Dissent by Justice Phillips), Justice Phillips discussed the power of an architect or engineer to damage a contractor, and the duty that the design professional owed to the contractor.

> There is no Texas case which decides the question before us, as to whether an architect or engineer owes a duty in tort to a prime contractor, where negligence on

the part of the architect or engineer causes the prime contractor economic damage.

* * *

In my judgment, the cases where a duty has been upheld are the better reasoned cases. In United States v. Rogers and Rogers, 161 F.Supp. 132, 135-136 (S.D.Calif.1958), the court stated:

Consideration of reason and policy impel the conclusion that the position and authority of a supervising architect are such that he ought to labor under a duty to the prime contractor to supervise the project with due care under the circumstances, even though his sole contractual relationship is with the owner, ... Altogether too much control over the contractor necessarily rests in the hands of the supervising architect for him not to be placed under a duty imposed by law to perform without negligence his functions as they affect the contractor. **The power of the architect to stop the work alone is tantamount to a power of economic life or death over the contractor.** It is only just that such authority, exercised in such a relationship, carry commensurate legal responsibility.

Id. at 376 (Emphasis supplied.)

The architect has an obligation to monitor the quality and extent of the contractor's work on the project (if so provided in the contract documents). To do so, the architect must become generally familiar with the work. If problems develop, the architect has a duty to advise the owner about the problems and to help protect the owner from the resulting consequences. If the architect does not advise the owner about the problems or make suitable recommendations to resolve them, the architect could face liability to the owner. *Hunt v. Ellisor & Tanner, Inc.*, 739 S.W.2d 933, 940

(Tex.App. – Dallas 1987).

-Schedule of Values

At the early stages of the construction project, the contractor submits a schedule of values to define values to be paid for the accomplishment of various tasks. The contractor has incentive to front end load the schedule of values, meaning that the contractor will be paid more of its money earlier than it is legitimately entitled. For example, mobilization occurs very early in the project. If the contractor's real mobilization costs are $10,000, but it requests payment of $100,000 in the schedule of values, the contractor will be ahead by $90,000. This "overpayment" depletes the money available to complete the project in case the contractor defaults or abandons the project.

Similarly, the contractor may submit an unbalanced schedule which assigns more value to a certain task than it deserves. An astute contractor may assign a high dollar value to a task the number of which the contractor expects to expand greatly during the project. Based on studying the project, the contractor may reasonably anticipate that the number will dramatically rise due to particular circumstances, and reap a windfall as a result. For example, the contractor may anticipate that many more feet of a particular type of pipe will be used on the project than was listed in the bid solicitation. The contractor may dramatically increase the value for this pipe, and enjoy substantial profits when the owner selects the pipe.

-Applications for Payment

Once the contractor and architect have agreed on a schedule of values, the contractor will submit applications for payment to pay the contractor for work done to the date of the application. The application will request payment based on the contractor's completing a certain percentage of

each task listed in the schedule of values. The contractor and architect will attempt to negotiate an agreeable percentage of completion, and amount of payment. The architect will have to review the contractor's work to determine if it generally conforms with the contract documents and is good and workmanlike. The AIA A201 General Conditions do not require the architect to exhaustively or continuously review the contractor's work. Such general conditions do however require the architect to ensure general conformance. If the architect certifies payment for work not complete or for work that is defective, the architect risks liability to the owner or to the contractor's surety should the contractor be defaulted or abandon the project.

If the architect determines that the contractor is entitled to payment, the architect will issue a certificate for payment authorizing the owner to make payment to the contractor. The certificate is a representation to the owner that the architect has reviewed the contractor's work, and that such work generally conforms with the contract documents.

-Inspection

The contract documents and the AIA provisions do not call for the architect to undertake an "inspection" of the contractor's work. The word "inspection" connotes a higher level of review than that actually required of the architect. The architect should resist describing the review of the contractor's work as an "inspection".

-Shop Drawings

The contract documents require the contractor to submit shop drawings and other submittals to the architect for review. The architect should assign experienced personnel for such review. Preferably, the project architect with intimate knowledge of the design intent should be involved.

If the contractor somehow changes the design through shop drawings or other submittals, the architect could face liability for failing to object or to note the change.

The importance of competent shop drawing review was dramatized on July 17, 1981, when two atrium walkways in the Kansas City Hyatt Regency collapsed. Forensic investigations revealed that the project structural engineer's shop drawing review was inadequate. The engineer's shop drawing review did not recognize the significance of a change proposed by the walkway supplier, a change which over stressed the support for the fourth floor walkway. As constructed, the fourth floor walkway could support only 60% of the minimum load required by Kansas City building codes. When the fourth floor walkway collapsed onto the second floor walkway causing both to crash to the floor, 114 people died and more than 200 were injured. More than $140 million was awarded to victims and their families from court judgments and settlements. The Hyatt walkway collapse remains a tragic study of design professional ethics and errors.

-Changes

The contract documents usually allow the parties to agree to changes. Sometimes, the contract prohibits oral changes or changes by persons lacking proper authority. Regardless, the parties may still agree to change the contract orally to create a new contract that allows oral changes. In *American Garment Properties, Inc. v. C.B. Richard Ellis-El Paso, L.L.C.*, 155 S.W.3d 431, 435 (Tex.App. -- El Paso 2004), the court stated that a written contract not required by law to be in writing may be modified by a subsequent oral agreement even though it provides that it can be modified only by a written agreement (citing *Mar-Lan Industries, Inc. v. Nelson*, 635 S.W.2d 853, 855 (Tex.App.-El Paso 1982, no writ). The *Garment* Court noted that courts have allowed oral

modification in spite of the parties' no oral modification clause, reasoning that the written agreement is of no higher legal degree than an oral one, and either may vary or discharge the other. *Id.*; see also *Lone Star Steel Co. v. Scott*, 759 S.W.2d 144, 153 (Tex.App.-Texarkana 1988, writ denied); *Group Hosp. Servcs., Inc. v. One and Two Brookriver Center*, 704 S.W.2d 886, 890 (Tex.App.-Dallas 1986, no writ); *Hyatt Cheek Builders-Engineers v. Board of Regents of the Univ. of Texas System*, 607 S.W.2d 258, 265 (Tex.Civ.App.-Texarkana 1980, writ dism'd).

Often, the contract documents provide a mechanism for pricing the changes. Pricing may be set in a variety of ways. For example, the parties may negotiate the change order price. Or, the contract may provide for unit prices for the extra work. Or, the parties may agree or the contract may stipulate to use time and materials, or for force account work. The contract may even limit or eliminate the contractor's overhead and profit. This provision can cause substantial hardship if abused. The owner could require the contractor to significantly increase the scope and complexity of the project paying the contractor little or no overhead and profit.

The AIA contract documents also provide for construction change directives, which allow the owner to make changes without the contractor's agreement. The change directive may specify how the contractor will be compensated for the change. The contractor may object, and the extra work essentially is done on a time and materials basis. The parties may subsequently negotiate the price to be paid.

-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.

-Claims & Disputes

Claims and disputes invariably arise on a construction project. Good and savvy construction administration can reduce or minimize the impacts on your project.

-Obligation of Continuing Performance

Many contracts contain a provision called the obligation of continuing performance, which requires the contractor to continue work on the project during the resolution of disputes. This provision can be useful to avoid delays while disputes are resolved. Should the contractor cease performing after an issue arises, the contractor could be liable for breach of contract to the owner. This provision is useful in defusing a dispute and removing from a contractor leverage to delay progress pending negotiations.

-Architect Decision

Many contracts require that disputes or claims first be submitted to the architect for a decision on the merits. In the absence of an architect's decision, one party or the other may contend that a prerequisite condition for a claim has not been satisfied. In *Tribble & Stephens Co. v. RGM Constructors, L.P.*, 154 S.W.3d 639, 652-53 (Tex.App. -- Houston [14th Dist.] 2004), the court upheld a contract provision that required a decision by an architect on particular issues (commonly known as a "satisfaction clause". The court stated :

> It is well established that a contract may require performance by one party to be subject to the satisfaction of the other party, or a designated third party such as an architect or engineer. See *Delhi Pipeline Corp. v. Lewis, Inc.*, 408 S.W.2d 295, 297-

98 (Tex.Civ.App.-Corpus Christi 1966), overruled on other grounds by *Tenneco Oil Co. v. Padre Drilling Co.*, 453 S.W.2d 814 (Tex.1970). Construction contracts commonly contain satisfaction clauses. See, e.g., *Tex. Dep't of Transp. v. Jones Brothers Dirt & Paving Contractors, Inc.*, 92 S.W.3d 477, 481 (Tex.2002) (listing cases addressing satisfaction clauses in construction contracts); *Black Lake Pipe Line Co. v. Union Constr. Co.*, 538 S.W.2d 80, 88-89 (Tex.1976), overruled in part on other grounds by *Sterner v. Marathon Oil Co.*, 767 S.W.2d 686, 690 (Tex.1989) (same). Generally, a satisfaction clause will be upheld unless it is shown that the arbiter of performance under the contract decided the matter due to fraud, misconduct, or such "gross mistake" that it implies bad faith or the failure to exercise honest judgment. See *Westech Eng'g, Inc. v. Clearwater Constructors, Inc.*, 835 S.W.2d 190, 202-03 (Tex.App.-Austin 1992, no writ); see also *Jones Brothers*, 92 S.W.3d at 481 (noting the standards applicable to satisfaction clauses); *First-Wichita Nat'l Bank v. Wood*, 632 S.W.2d 210, 214 (Tex.App.-Fort Worth 1982, no pet.) (noting cases concerning an architect's authority to pass final approval on construction work). However, it must appear from the express terms of the contract that the parties intended determination by a third party to be final; such a provision may not be implied. *Delhi Pipeline*, 408 S.W.2d at 298.

The *Tribble* court cautioned against a court substituting its judgment for that of the architect. The court reasoned that:

> [A]n architect's decision cannot be set aside by proving that some other architect may have acted or decided an issue differently or "simply on a conflict of evidence as to

> what [ ]he ought to have decided. This must be true, because any other rule would simply leave the matter open for a court or jury to substitute its judgment and discretion for the judgment of the [architect]." *Westech Eng'g*, 835 S.W.2d at 203 (quoting *City of San Antonio v. McKenzie Constr. Co.*, 136 Tex. 315, 150 S.W.2d 989, 996 (1941)).

Id. at 653.

-Mediation

Many contracts require that claims be mediated before they can be arbitrated or litigated. Mediation is a non-binding settlement process overseen by a neutral third party mediator, who acts as a settlement facilitator.

In *In re Pisces Foods, L.L.C.*, 228 S.W.3d 349, 353-54 (Tex.App. -- Austin 2007), the court discussed a contract which expressly required mediation as a precondition to arbitration. The court held that agreement bound the claimant, and that the trial court could not compel arbitration without mediation occurring first. The court found that there was no allegation or proof that either party requested mediation, that they held a mediation, or that the defendant resisted participating in mediation. The court noted that the claimant simply failed to comply with the terms of its contract by not mediating with the defendant before demanding arbitration. Since mediation had not occurred, the court held that the arbitration clause had not been properly triggered, and the trial court could not validly compel the parties to arbitrate. The court declined to express any opinion regarding whether the claimant had waived the right to arbitrate by failing to satisfy the preconditions, and held simply that the right to compel arbitration had not yet accrued under the terms of the contract. The court declared that based on the undisputed record presented here, the

trial court did not abuse its discretion by refusing to compel arbitration.

Mediation generally occurs in less than a day, and the mediation fee ranges from $1,000 to $3,000, depending on the mediator. Many mediators have a settlement success percentage in excess of 80.

-Arbitration

Arbitration is a voluntary but generally binding dispute resolution mechanism. Often the contract calls for arbitration of disputes under the then prevailing Construction Industry Rules of the American Arbitration Association. The AAA forms can be found at its website: http://www.adr.org. The forms for filing an arbitration demand are located at: http://www.adr.org/sp.asp?id=29042 ; while the Construction Industry Rules can be found at: http://www.adr.org/sp.asp?id=22004 .

Parties generally cannot be compelled to arbitrate unless they have agreed to do in writing, although there is an exception where the circumstances call for equitable estoppel. In *Meyer v. WMCO-GP, LLC*, 211 S.W.3d 302, 305 (Tex.2006), the trial court refused to compel arbitration between a signatory and a non-signatory. The court of appeals affirmed. The Texas Supreme Court held that the trial court abused its discretion in refusing to compel arbitration, since equitable estoppel was appropriate. *Id.* at 305-06. There, A motor vehicle manufacturer exercised its right of first refusal to acquire its dealer's business and transferred the right to its assignee, preempting the dealer's agreement to sell the business to another. The jilted buyer sued the manufacturer and its assignee for interfering with the proposed contract of sale. Although the defendants had no contract with the jilted buyer, they demanded arbitration based on the buyer's agreement to arbitrate disputes with the dealer. The Supreme Court stated that a person who has agreed to arbitrate

disputes with one party may in some cases be required to arbitrate related disputes with others. The court noted that this suit by a signatory to an arbitration agreement against a non-signatory was such a case. The court declared that a person who seeks by his claim to derive a direct benefit from the contract containing the arbitration provision may be equitably estopped from refusing arbitration. The court observed that when a party's right to recover and its damages depends on the agreement containing the arbitration provision, the party is relying on the agreement for its claims.

If the parties have agreed to arbitrate their disputes, and one party attempts to litigate in court, the other party may generally secure an order from the court staying litigation and compelling arbitration In other words, if the contract provides for arbitration, the chance to litigate in court may be lost unless the other party agrees to waive arbitration, either expressly or by implication.

In *In re U.S. Home Corp.*, 2007 WL 2965079 (Tex. 10/12/2007), two couples sued for themselves and others similarly situated alleging that their homes had been built without shower pans. Their sales contract had an arbitration provision. The trial court denied defendants' motion to compel arbitration, and granted the plaintiffs' motion to certify a class action. The Supreme Court reversed and overturned the trial court's finding that the contractual provision for arbitration was unenforceable due to its being a contract of adhesion. The Supreme Court declared that adhesion contracts are not automatically unconscionable, and there is nothing per se unconscionable about arbitration agreements. The Supreme Court observed that the plaintiffs only proved that US Home refused to contract with them unless they agreed to arbitration, which was not enough to invalidate the provision. The Supreme Court also rejected the plaintiffs' arguments that the arbitration provision had been procured by fraud, there was lack of mutual consideration, the arbitration process was unduly burdensome and costly, and the plaintiffs should not have to arbitrate with

defendants with whom they did not have a contract. The Supreme Court also declined the defendants' request to reverse the class certification, pointing out that the U.S. Supreme Court has expressly held that an arbitration clause covering "all disputes relating to a contract" includes disputes about class certification.

One benefit of arbitration is that it generally occurs before a construction industry professional or an attorney who practices construction law, with the parties having some input into the arbitrator selection. Litigation, on the other hand, occurs before a judge often not conversant with construction issues, or not inclined to entertain them, and a jury with no familiarity with the construction process, industry standards and industry customs.

Another benefit of arbitration is that it can occur with the owner without involving the contractor. Sometimes, a construction problem (such as a roof leak) may either be caused by a design error or a construction defect. The owner is best suited by having the architect and the contractor in the same dispute resolution proceeding. If the owner is compelled to arbitrate with the architect and without the contractor, the architect may more easily prove that the source of the owner's grief is a construction defect and not a design error. This is so principally because the owner has to candidly admit that the problem may be caused by either a construction defect or a design error, and the contractor is not present to defend itself and prove the existence of a design defect.

-Retainage

Retainage is generally held to ensure the contractor's interest in completing the project, correcting defects, and paying for labor and materials. On private projects, where the contractors

may place mechanic's liens, the owner is required by Chapter 53 of the Texas Property Code to withhold 10% in retainage until 30 days after the project is fully complete. If the owner is required to withhold retainage, but does not do so, the owner can be liable to mechanic's lien claimants for the amount of retainage not properly withheld.

Often the contract specifies the amount of retainage to be withheld. On public projects, the percentage may be reduced to 5%, by withholding 10% for the first half of the project, and nothing during the remainder.

Retainage is withheld based on the money paid to the contractor, and should reflect the value of change orders, and adjustments in the contract amount.

Additional retainage should be withheld to cover the reasonable cost of correcting defects in the contractor's work. If the contractor is not for whatever reason inclined to correct defects, the architect should ensure that money remains in the contract balance to address the defects.

If the contractor is not paying properly for its labor or materials, the architect should withhold money reasonably calculated to protect the owner from claims by the unpaid laborers or suppliers.

The ultimate goal of retainage is to protect the owner should the contractor not properly complete its contract or pay for its work. Also, the contract balance should be sufficient to complete the project if the contractor were to abandon the project. As the prospects of a contractor properly completing the project become bleaker, the architect should be more and more zealous in protecting the contract balance. This is especially true if there is any chance that the owner will look to the contractor's surety to complete the project.

In *Beard Family Partnership v. Commerical Indemnity Ins. Co.*, 116 S.W.3d 839 (Tex.App.

-- Austin 2003), at issue was whether a performance bond surety had to comply with all the terms of the contract that were imposed on the contractor to receive payment. One such term at issue was an "all bills paid affidavit" that the owner demanded from the surety before the owner would make payment. The court first analyzed the nature of suretyship, stating that suretyship is a tripartite relationship in which the obligation of the surety is intended to supplement an obligation of the principal (also described as the debtor or obligor) owed to the creditor (also described as the obligee). (Citing Restatement (First) of Security § 82 (1941)). The court reasoned that two parties were liable for the debt, although one (Commercial Indemnity as the contractor's surety) owed the other (Beard as the owner) the duty of ultimate payment. The court observed that with the performance bond, the surety was liable for a default in the performance by the principal of its contract obligations. *Id*. at 845. The court stated that because they are contracts, performance and payment bonds are construed to effectuate the parties' intentions. The court noted that when the provisions are clear and unambiguous, a court must enforce the terms of the bond as written. The intent of the parties to a surety bond as well as their rights and obligations are determined by the language of the bond itself. (Citing *Geters v. Eagle Ins. Co.*, 834 S.W.2d 49, 50 (Tex.1992)). The court declared that although the performance and payment bonds at issue incorporated the terms and conditions of the construction contract, any conflicting clauses must be harmonized to reflect the intent of the parties. (Citing *Ogden v. Dickinson State Bank*, 662 S.W.2d 330, 332 (Tex.1983)).

The *Beard* court held that when it read together and harmonized the underlying contract's provision regarding the requirement of an all-bills-paid affidavit from the contractor, together with the bonds, the intent of the parties made it clear that the affidavit is not a requirement also imposed upon the surety. The court reasoned that in addition to the affidavit, paragraph 9.10.2 of the general

conditions also required the "consent of surety, if any, to final payment." Because the surety was the assurance of payment – and continued to be liable on the bond until the expiration of a specified time period – an all bills paid affidavit from the surety would under these circumstances perform no function. *Id*. at 846.

The *Beard* court also stated that the performance bond required as a condition precedent that the owner perform its obligations before the surety was required to perform under the bond. By the terms of the performance bond, the surety's obligation arises only when the "Contractor [is] ... declared by Owner to be in default under the Contract, the Owner having performed Owner's obligations thereunder." Since the jury in this cases found that Beard had failed to perform and that Commercial Indemnity substantially performed the underlying contract, Beard was not excused from performance. *Id*. at 846-47.

The lessons from *Beard* are that a surety need not fully comply with all the terms and conditions of the construction contract to receive payment, and that the owner has to honor its contract obligations before it may make a valid demand on the surety for performance.

-Contract Time

The contract time is the time specified in the contract for the completion of the project. If no time is specified, then the work must be done within a reasonable amount of time. If the owner wishes to hold the contractor responsible for not completing on time the contract must state that "time is of the essence". This is viewed as magic language by the courts, and in its absence, courts will not hold the contractor responsible for the cost of daily delays.

-Extensions

The contract time should be reasonably extended for delays beyond the contractor's control. If the contractor seeks an equitable extension of contract time, and the architect and owner refuse to grant it, the owner could be liable for a constructive acceleration of the contractor's work. Essentially, this means that the contractor has to undertake more or the same amount of work, but in less time. To accomplish the work, the contractor may have to work overtime or double shifts, and either incur additional costs or suffer inefficiencies. Either way, the contractor may seek to recover damages via an acceleration claim.

-Delays

If the owner sustains damages from the contractor's delay on the project, the owner may be entitled to payment from the contractor. Often the contract restricts or prohibits the recovery of consequential damages, such as lost profits or loss of use. One way around this restriction is a liquidated damages provision.

-Liquidated Damages

A liquidated damages provision establishes an agreed amount of money to be paid for unexcused delays by the contractor in completing the project. The amount set must be a reasonable forecast of the owner's damages in the event of a delay. A liquidated damages provision will be enforced when the court finds: (1) the harm caused by the breach is incapable or difficult of estimation; and (2) that the amount of liquidated damages called for is a reasonable forecast of just compensation. The party asserting that a liquidated damages clause is, in fact, a penalty provision has the burden of proving this defense. In order to meet this burden, the party asserting the defense is required to prove the amount of the other parties' actual damages, if any, to show that the

liquidated damages are not an approximation of the stipulated amount. If the liquidated damages are shown to be disproportionate to the actual damages, then the liquidated damages must be declared a penalty and recovery limited to the actual damages proven. *Commercial Union Insurance Co. v. La Villa Independent School District*, 779 SW2d 102, 106-07 (TexApp -- Corpus Christi 1989). See also *Stewart v. Basey*, 150 Tex. 666, 245 SW2d 484 (1952).

-No Damages for Delay

Ordinarily, an 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 required 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 since the owner had caused the delays and increased the costs, the owner 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 no damages for delay clause, which the court held 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.

-Requests for Interpretation

If the construction documents are unclear, or if the contractor needs more information, the contractor can submit a request for interpretation (also known as a request for information or request for clarification). The architect then has an obligation to respond timely. If the architect does not respond timely, the contractor could legitimately request additional contract time.

-Substitutions

The contractor ordinarily is required to seek approval for a substitution or deviation from the contract documents. Sometimes a substitution is necessary because the specified product is not available or is no longer manufactured. Regardless, substitutions can be problematic for the architect. If for any reason the substitution does not perform properly, the architect will have some explaining to do to the owner. The architect should ensure that the contractor warrants or represents that the substitution satisfies the design intent, and will perform properly.

-Progress Meetings

The architect should hold and act as the chair for progress meetings on a regular basis to keep control of the project. The architect should keep the minutes for the meeting and distribute them to the attendees and those with an interest in the project. The minutes should require the recipients to advise the architect in writing within five business days of any errors or omissions in the minutes. The minutes act as the official record of what transpired at the progress meeting and as a recap of the project's progress. Good minutes can save an architect significant time, trouble and liability later.

-Inspections

Under the standard AIA contract documents, the architect is required to become generally familiar with the contractor's progress on the project and to determine whether the work is generally progressing in conformance with the intent of the contract documents. The architect is not required to make continuous or exhaustive inspections of the contractor's work. The word "inspection" connotes a greater level of scrutiny than that required under the AIA contract documents.

-Rejection of Work

The architect should be on guard for defective work – work that does not conform with the contract documents. If the architect certifies payment for defective work, the architect will have some explaining to do with the owner. If the architect certifies payment for defective work, the architect may also have to deal with the contractor's surety if the project is bonded and the contractor defaults.

-Care and Feeding of the Contractor's Surety

If the obligee has not acted according to the terms and conditions of its contract, the surety may be discharged or exonerated in toto. *Vastine v. Bank of Dallas*, S.W.2d (Tex. 1991); *Old Colony Insurance Co. v. City of Quitman*, 163 Tex. 144, 352 S.W.2d 452, 455 (1961)(Owner's failure to adequately inspect work and overpayment to contractor discharges surety's obligation on bond.). *Fort Worth Independent School District v. Aetna Casualty & Surety Co.*, 48 F.2d 1 (5th Cir. 1933)(Owner is obligated to protect the surety's rights and not do anything to increase the surety's risk.).

-Indemnification

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.

Texas Government Code §2252.902 invalidates a covenant, promise or agreement in a construction contract, or any collateral agreement, involving Texas state public work, which seeks to have a party indemnify a person (known as the "indemnitee") against all or any portion of loss or liability for damage resulting from the sole, joint, or concurrent negligence of the indemnitee, or its agent, employee or another independent contractor directly responsible to the indemnitee, arising from personal injury or death, property damage on the project. Section 2252.902 does permit

indemnity for loss or liability for damage that is caused by or results from the sole, joint, or concurrent negligence of the indemnitee or its agent or employee and arises from the bodily injury or death of an employee of the indemnitor, the indemnitor's subcontractor, supplier, or equipment lessor, or any lower tier subcontractor, supplier, or equipment lessor. Section 2252.902 expressly states that it does not affect insurance contracts, and may not be waived by contract.

Texas Government Code §2254.0031 prohibits a Texas state governmental entity from requiring indemnity from a contractor for the claims or liabilities resulting from the negligent acts or omission of the state governmental entity or its employees. Section 2254.0031 does permit the governmental entity to require indemnity from claims and liabilities resulting from the negligent acts or omissions of the contractor or persons employed by the contractor.

-Insurance

One way to resolve disputes on a construction project is through the purchase of insurance. Insurance can provide the magic elixir (money) necessary to resolve indemnity obligations, repair construction defects, and pay for injury claims. In addition to the types and amount of insurance, there are two other issues of note for the architect: Additional insured status and waiver of subrogation.

-Additional Insured

Simply because the contractor has insurance to cover a loss does not mean that there will be no litigation or claims. If a contractor's employee is injured on the job site, the employee may sue the owner, architect, and any one else arguably responsible for the injury. The architect may have good and valid defenses to the claim, but the cost of defense can be more than the cost of settling

the claim. One way to resolve that problem is for the contractor to name the architect as an additional insured on the contractor's comprehensive general liability insurance policy. Often there is no cost for the additional insured status certificate . Sometimes the cost is as nominal as $100. As an additional insured, the architect will be represented by the contractor's attorney in a suit covered by the contractor's insurance. Better yet, the contractor pays the deductible. Also, with the contractor's attorney representing the architect, there is less chance that the contractor will file a cross claim or third party claim against the architect to have the architect share in the cost of paying the claim.

-Waiver of Subrogation

If a claim is covered by insurance, chances are the insurer will adjust and pay the claim. After payment, the insurer becomes subrogated and is then entitled to sue those parties responsible for causing the loss in the first place. A waiver of subrogation provision in the contract is designed to prevent the contractor's insurer from simply suing the architect or owner after paying a covered loss. In *TX. C.C., Inc. v. Wilson/Barnes General Contractors, Inc.*, 2007 WL 2421472, *3 (Tex.App. -- Dallas 2007), the court held that a waiver of subrogation barred an insurer from suing to recover for its losses even after the project was completed.

-Safety

The architect should generally steer clear of dictating safety precautions on the project. If the architect dictates how the contractor will promote safety, the architect risks being held liable if the precautions do not work or do not work as intended. Instead, the architect should place the onus on the contractor to abide by all OSHA rules and good safety practices without specifying the actual

requirements. It is important that the architect allow the contractor to control its own means, methods, techniques and sequences during the construction project so that the architect can avoid such control that the architect becomes responsible

Owners, generally, have no duty to ensure that an independent contractor performs its work in a safe manner. The independent contractor is responsible for training and monitoring his own employees. An owner can be liable to the independent contractor's employees for injuries sustained on the job, but only to the extent the owner retained contractual or actual control of them. Where there is no contract granting the owner such control, and no evidence that it exercised actual control (or was even present) when the contractor's employees performed the work that resulted in the injury. Even if the owner knew that the work could be "very dangerous," but failed to warn the contractor of the hazards involved, the duty to warn independent contractors of concealed hazards applies to premises conditions (which an owner should know about) rather than the contractor's own work (which the contractor should know about). There is no duty to warn of an obvious danger. Also, courts will look to see if there is evidence that the owner trained the contractor or its employees, or monitor the training that the contractor provided. It is also important whether or not there is evidence that the owner retained a right to control the training of the contractor's employees. While an owner may provide some instruction to the contractor, say for example on use of lock-out and tag-out safety procedures, such instruction does not impose on the owner a duty to monitor compliance. An owner that provides training materials to an independent contractor is not liable if the latter fails to use them. See, *Central Ready Mix Concrete Co. v. Islas*, No. 05-0940 (Tex. 6/29/2007).

-Mechanic's Liens

If a contractor or subcontractor or supplier is not paid on a private project, they generally will have rights under Chapter 53 of the Texas Property Code to file a mechanic's and materialman's lien affidavit against the project. In that event, the owner (or the general contractor if the lien was filed by a subcontractor or supplier) may secure a bond to indemnify against the lien. Upon filing of the bond to indemnify against the lien, lien is then no longer an encumbrance on the owner's real property, but instead attaches to the bond. The clerk of court is required to provide notice of filing to the lien claimant. The notice commences the statute of limitations for the claimant to file suit on the bond.

-Owner's Decision

The contract documents may provide that the owner has the right to decide the merits of a dispute on the project. This provision is common in state contracts, which set up an administrative dispute and appeal process. If the contractor fails to abide by the process, the contractor could forfeit its claim. However, the Texas Supreme Court has held that the owner's decision must be made in good faith. *Black Lake Pipe Line Co. v. Union Constr. Co.*, 538 S.W.2d 80, 88-89 (Tex. 1976).

-Termination

Contracts may be terminated for default or, if so provided by the contract, for convenience.

-Default

A contract may be terminated for default for any of the reasons specified in the contract or simply where the contractor has breached the contract in a material way. A termination for default may be proper, for example, where the contractor has failed to complete a project within the time allowed by the contract (provided that time had been specified to be of the essence). However, terminating a contractor for default is risky, and there should be substantial grounds supporting the propriety of the termination.

For example, say an owner terminated a contract for failure to complete on time, but the contract did not specify that time was of the essence. The owner may then have a difficult time proving that the contractor's failure to complete on time was a material breach of contract, and one that justified the termination.

Simply put, termination is a drastic move, and should not be taken lightly. Upon termination, the contractor no longer has to complete the project, and may have the money and inclination to pursue legal relief. Upon being freed from the project, the contractor has time to plan a suit for a wrongful termination, and a strategy for recovering damages from the owner. If the architect certified that the contractor was in default, the architect could then face liability to the owner for a wrongful certification. There are safer alternatives, which will be discussed below.

Before terminating a contractor for default, the owner should provide the contractor with notice of default, and a reasonable opportunity to cure the default. This is true even if the contract provides only a limited time before the termination is final. The notice permits the contractor to explain away the alleged default. If the delay is due to causes beyond the contractor's control, a termination for default may be improper. It is usually less expensive for the contractor to correct

and complete its own work since it is already mobilized on site, and could forgo overhead and profit. A replacement contractor will have a learning curve and faces the risk of having to correct latent defects.

The equation is further complicated if the contractor posted a performance bond. The surety is not compelled to take action until there is a default of the contractor, its principal. Upon notice of the default, and the termination of the contractor's contract, the surety is entitled to investigate to determine how or if it should proceed. The performance bond surety generally is not required to undertake construction work. The surety can choose any of the following options (or more depending on the circumstances):

-Write a check to the owner to cover an agreed upon amount of damages.

-Pay the penal sum of its bond, which should conclude the surety's performance bond exposure.

-Tender a replacement contractor, and have the owner contract with the new contractor. The surety may or may not pay the new contractor.

-Enter into a three way contract with the owner and the replacement contractor to ensure that the work is completed and the new contractor is paid.

-Enter into a takeover agreement with the owner, and a completion agreement with the replacement contractor.

-Retain its principal to complete the project. Nothing in the performance bond prohibits the recycling of the principal for work on the project.

-Do nothing, have the owner complete the project at the owner's cost, and negotiate the owner's claim after the project is finished.

-Complete some or all of the project, and sue the owner to recover some or all of the completion costs.

If the surety is not timely informed of its principal's defaults or shortcomings, the surety may contend that it has been prejudiced, and discharged from its performance bond. If the owner (or architect) pays the contractor for work not done, or not done properly, the surety may contend that the owner has overpaid the contractor, prejudiced the surety and discharged some or all of the surety's performance bond obligations. If the contractor is paid for a greater percentage of its work than is appropriate, the surety may have an overpayment defense. If the owner does not in a timely manner default the contractor or notify the surety of problems with the contractor's performance, the surety may contend that it has been prejudiced and discharged in whole or part from its performance bond. (The care and feeding of the performance bond surety is a seminar unto itself.)

A termination for convenience provision permits the owner to send the contractor packing, without risking a suit or claims involving work not yet done. The termination for convenience clause can be useful in negotiations for extra work or to resolve claims. The owner can point out to the contractor that the owner will simply terminate the contract for convenience if the contractor does not negotiate reasonably. If the owner does terminate for convenience, the owner will owe the contractor for the reasonable value of the work done to the date of the termination.

The owner may also suspend work until a construction or design problem is resolved. If the contract contains a no damages for delay provision, the owner will not owe the contractor compensation for a reasonable delay. The owner can use the suspension to focus the contractor's attention on resolving a particular problem. When the contractor has no other work that it can do,

it may be more amenable to cooperating.

The owner may also supplement the contractor's work force, by retaining another contractor to perform some of the remaining work. The owner can then issue a deductive change order to reduce the original contractor's work scope and compensation. There will be less conflict if the deduct matches the original contractor's schedule of values for the tasks at issue.

-Substantial Completion

Substantial completion of the contract generally occurs when the work has progressed to the point where the owner can take beneficial occupancy and use the work for its intended purpose. For example, with a building project, substantial completion has probably occurred when the building code jurisdiction issues a certificate of occupancy. By the time of substantial completion, the contractor should be paid all of the contract balance save the retainage. The retainage should include that specified by the contract plus any amount reasonably necessary to protect the owner from a default by the contractor. The date of substantial completion signifies the cessation of contract time. If liquidated damages are owed by the contractor, the amount should be assessed and added to the retainage being held.

The date of substantial completion commences the running of the warranties on labor and materials.

-Acceptance

The owner issues an acceptance of the project when all of the work has been satisfactorily completed. The date of acceptance may start running the applicable statute of limitations for claims

on the contractor's work.

-Final Payment

Final payment is usually due when the owner accepts the project, and the contractor has submitted the various close out materials. If the contractor fails to submit all the required documents, the owner may withhold an amount reasonably calculated to cover the cost of reproducing the missing materials.

-Warranty Claims

There is a difference between a warranty claim and a breach of contract claim. Warranty is implicated for something that performed properly at one time, but later became defective. Contract breach relates to work that was not performed or was not performed properly. The distinction is important for final payment. The owner should not withhold money for warranty claims, unless the contractor has shown no inclination to address them. The owner can and should withhold money for contract breaches, until the problem has been satisfactorily resolved. An architect could face liability for either recommending that money be withheld when it should not be, or for not recommending that money be withheld when it should be.