Avoiding Killer Contract Clauses
Texas Society of Professional Engineers
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Avoiding Killer Clauses

- Simply constructing the project on time and on budget is not risky enough
- Additional risks courtesy of contract allocation
Contract Definition

✓ Contract is a binding agreement between 2 or more parties with consideration for performance
✓ Meeting of the minds
Traditional Contract Risk Assignment

- Traditionally, contract risk allocated to party with control over the risk
- Today, A/E is responsible for many risks over which A/E has no control
Inequitable Allocation of Risk

- A/E has no control over site conditions
  - Owner selects site
- No damage for delays
- Conditions precedent to payment
Minimizing Exposure to Inequitable Risk

- Negotiate out killer contract clauses during contract review
  - Not possible for public works contracts
- Some killer clauses not enforceable as matter of law
  - E.g., notice of claims < 90 days
Killer Contract Clauses

✔ Notice requirements
  - Notice of extra work, delay or differing site condition
  - E.g., no claim is valid unless presented within 14 seconds of facts giving rise to claim
Killer Contract Clauses

✔ Notice requirements
  - University of Texas Systems
    • Requires legal authorities, all evidence, and all facts to support claim to be submitted with claim
    • Contractor must hire attorney before dispute arises
Killer Contract Clauses

✓ Texas Civil Practice & Remedies Code Section 16.071
  – Anti-Notice provision
Texas Civil Practice & Remedies Code Section 16.071

(a) A contract stipulation that requires a claimant to give notice of a claim for damages as a condition precedent to the right to sue on the contract is not valid unless the stipulation is reasonable. A stipulation that requires notification within less than 90 days is void.

(d) This section applies to a contract between a federal prime contractor and a subcontractor, except that the notice period stipulated in the subcontract may be for a period not less than the period stipulated in the prime contract, minus seven days.
Killer Contract Clauses

☑️ Differing Site Conditions
  - Conditions which differ in some degree from that which the parties expected
Killer Contract Clauses

✓ Differing Site Conditions
  – Differing site conditions clause
    • Allows contractor to delete contingencies
    • Contractor only paid extra when unusual conditions are actually encountered
Differing Site Conditions Clause

- Reasons for owner not to use
  - Owner does not build often enough
  - Owner has limited funds
  - Contractor has incentive to minimize extra costs
Killer Contract Clauses

✓ Differing Site Conditions Clause

- Reasons for owner not to use

  • Empirical evidence - contractors do not properly quantify risk
  • Eliminating clause may cost owner little or nothing
Killer Contract Clauses

✓ Federal Government Differing Site Conditions Clause
  - Takes precedence over conflicting contract language
  - Often included in federally funded contracts
Killer Contract Clauses

2 Types of Differing Site Condition Clauses

- Type I
  - Conditions differ materially from those indicated in contract documents
  - Representation of conditions need not be explicit
Killer Contract Clauses

✓ Differing Site Conditions
  – Type I
    • Contract documents must provide sufficient grounds to justify bidder’s expectation of latent conditions materially from those actually encountered
Killer Contract Clauses

☑ Differing Site Conditions
  – Type II
    • Unusual physical conditions differing materially from those ordinarily encountered in the work of the character at issue in the contract
Killer Contract Clauses

✓ Differing Site Conditions
  - Contractor must still make at least minimal investigation of site
  - Today’s contracts usually require contractor to investigate site conditions, labor and utility availability
Differing Site Conditions
- Site inspection clause
  - Contractor must inspect site
  - If contractor unreasonably fails to inspect site, DSC clause may not be available
Differing Site Conditions

- If contractor makes reasonable inspection of site, but does not find DSC, DSC clause and site inspection clause may conflict
Differing Site Conditions

- Courts resolve conflict between DSC clause and site inspection clause with standard of reasonableness
  - Contractor not required to discover hidden conditions, not apparent through reasonable investigation
Killer Contract Clauses

✅ Disclaimers to Differing Site Conditions Clause

- Information owner provided is not warranted by owner
  - Purpose: Render unreasonable any reliance on owner-provided information
Killer Contract Clauses

☑ Differing Site Conditions
  – Disclaimers
  • Should provide that owner’s info is not warranted, and contractor cannot rely on info in basing bid
  • Combine with site inspection clause
Killer Contract Clauses

**Disclaimers to Differing Site Conditions Clause**

- Court interpretations:
  - With disclaimer, contractor has to prove deception or bad faith on owner’s part or show that owner withheld material info that it had a duty to disclose
Killer Contract Clauses

✓ Disclaimers to Differing Site Conditions Clause
  – Ineffective
    • Reliance permissible where contractor performed reasonable investigation
    • Or owner intended contractor to rely on info
    • Or insufficient time for adequate investigation
Killer Contract Clauses

✓ No Damages for Delay

- Ordinarily, owner is liable for delays
  - E.g., owner’s failure to obtain rights of way
- With no damages for delay clause, no liability on owner for delay
‡ No Damages for Delay

– “Owner shall not be liable to Contractor for delays or any kind or nature in the progress or completion of the work on the Project. Contractor’s sole remedy for any delay whatsoever shall be an equitable adjustment of contract time.”
Killer Contract Clauses

✓ No Damages for Delay
– Exceptions
  • Delay not contemplated by parties
  • Owner’s active interference
  • Unreasonable delay
  • Material omission or misrepresentation of site conditions
Killer Contract Clauses

✔ Living with No Damages for Delay
  – Avoid by focusing on costs of added time for change
  – Do not use word “delay” in claims
  – Capture job costs with cost coding for changes
Killer Contract Clauses

Pay When Paid vs. Pay If Paid

- Pay when paid:
  - “A/E will pay subconsultant within 10 days of payment by owner”
  - Does not pass risk of non-payment
  - Only delays payment for reasonable time
🔍 Pay When Paid vs. Pay If Paid

– Pay if paid:

• “A/E will pay subcontractor if and only if A/E is paid first by owner for subconsultant’s work, payment by owner being an express condition precedent to A/E’s obligation to pay subconsultant. Subconsultant assumes the risk of non-payment by owner, and looks to owner for the source of funds on the project.”
Killer Contract Clauses

✓ Changes Clause
  - Applicable to work beyond contract scope
  - Problem with defining contract scope
    • Implied work from plans and specs
Killer Contract Clauses

✅ Changes Clause

- Constructive Changes
  - Change that only one party recognizes
  - E.g., constructive acceleration
Killer Contract Clauses

✅ Changes Clause

- Pricing
  - Limitation to actual cost (no markup for overhead or profit) or cost plus 10%
Killer Contract Clauses

✓ Indemnity
  – Express Negligence Doctrine
    • Indemnity for one’s own negligence must be expressly stated
    • AIA A201 General Conditions do not satisfy
AIA A201 General Conditions Indemnity (1987)

3.18.1 To the fullest extent permitted by law, the Contractor shall indemnify and hold harmless the Owner, Architect, Architect’s consultants, and agents and employees of any of them, from and against claims, damages, losses and expenses, including but not limited to attorneys’ fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself) including loss of use resulting therefrom, but only to the extent caused in whole or in part by negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder. Such obligation shall not be construed to negate, abridge, or reduce other rights or obligations of indemnity which would otherwise exist as to a party or person described in this Paragraph 3.18.
Killer Contract Clauses

✓ Indemnity
  − Clause must be conspicuous or provide fair notice
    • Must be apparent to a reasonable person
  − Clause must satisfy express negligence test at time of contract signing
Indemnity Clause

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.
Killer Contract Clauses

✓ Indemnity

- Texas Civil Practice & Remedies Code Section 130.002

  • Invalidates attempt to have contractor indemnify A/E for liability for personal injury or property damage arising from A/E negligence in preparing plans and specs or in contract administration
Indemnity

✓ Texas Gov't Code § 2252.902
  - Indemnity Provisions in Construction Contracts
  - Application:
    • construction, alteration, or repair, of state public building
    • or any state public work
Indemnity

✓ Section 2252.902 (cont’d)

– Except for Subsection (c), agreement in construction contract is unenforceable to extent that it indemnifies a person against all or any portion of liability for damage that:

– (1) results from the sole, joint, or concurrent negligence of the indemnitee, its agent, employee, or another independent contractor directly responsible to the indemnitee;
Indemnity

✓ Section 2252.902 (cont’d)
  - and
  - (2) arises from:
    - (A) personal injury or death;
    - (B) property damage;
    - (C) fine, penalty, administrative action, or other action assessed by governmental entity directly against indemnitee, its agent or employee, or an independent contractor directly responsible to the indemnitee; or
    - (D) any other loss that arises from an occurrence described by Paragraphs (A), (B), or (C).
Indemnity

✓ Section 2252.902 (cont’d)

– (c) Agreement in construction contract may require a person to indemnify, hold harmless, or defend another person against loss or liability for damage that 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:

– (1) the indemnitor;
– (2) the indemnitor's subcontractor, supplier, or equipment lessor;
– (3) any lower-tier subcontractor, supplier, or equipment lessor of the indemnitor's subcontractor; or
– (4) any independent contractor directly responsible to a person described in Subdivisions (1)-(3).
Section 2252.902 (cont’d)

- (d) This chapter does not affect the validity and enforceability of:
  - (1) an insurance contract;
  - (2) benefits and protections under the workers' compensation laws of this state; or
  - (3) any statutory right of contribution.
- (e) This section may not be waived by contract or otherwise.
Indemnity

✓ Texas Gov't Code § 2254.0031. Indemnification

– State may require contractor to indemnify State from claims:
  • resulting from negligent acts or omissions of contractor or persons employed by the contractor
  • State may not require contractor to indemnify State for claims resulting from negligent acts or omissions of the State or its employees
Killer Contract Clauses

- **Indemnity**
  - If owner requires indemnity for owner’s negligence, buy insurance
  - Indemnity for owner’s negligence also covers gross negligence
Killer Contract Clauses

✓ Disclaimers of Liability

– Owner may disclaim liability for:

  • Defects in plans & specs
  • Non-availability of materials
  • Extra costs that contractor may incur for variety of reasons
Killer Contract Clauses

✔ Disclaimers of Liability
  – Disclaimer of liability for special, incidental, indirect, and consequential damages
Killer Contract Clauses

✅ Limitations of Liability
  - Assumption of risk has value
  - Liability limited to compensation received
  - Liability limited to insurance proceeds
  - Liability limited to a set amount
Killer Contract Clauses

- Limitation of Liability
  - Limitation of A/E’s liability to subconsultant to amount paid by owner
  - Liability on comparative negligence basis
Killer Contract Clauses

Incorporation by Reference

- Incorporates by reference many items not attached to contract
  - Become fully part of contract
  - Beware onerous provisions
  - Difficulty in obtaining incorporated documents
Killer Contract Clauses

✓ Incorporation by Reference
  – Contrary or inconsistent provisions
  – Also may be used to subject subconsultant to same obligations to A/E as A/E owes to owner
Killer Contract Clauses

✓ Liquidated Damages
  – Pre-determined damages for late completion
    • When starts?
    • When stops?
    • Calendar vs. working day
Killer Contract Clauses

✓ Obligation of Continuing Performance
  – Requires A/E to continue working despite dispute
  – A/E may have to work without pay
Killer Contract Clauses

Right to Stop Work
- Right exists under Texas law as remedy for breach of contract
  - May be contractually barred
Killer Contract Clauses

- Termination for Convenience
  - Allows owner to terminate contract for owner’s convenience
  - Limits owner’s liability to specified amount
Killer Contract Clauses

✓ Final Payment as Waiver of All Claims
  – A/E’s acceptance of final payment may waive all claims against owner
Killer Contract Clauses

✓ Venue
  - Venue for all suits may be in a foreign or inconvenient state or location
Killer Contract Clauses

✓ Attorney’s Fees
  – Texas law provides for attorney’s fees for recovery of money under contract
    • Expert costs not included
  – Clause may permit recovery of expert and internal management costs
Killer Contract Clauses

✔ Decision on All Claims is Final
  - Owner’s or A/E’s decision on merits of claim may be binding on contractor with no redress to courts
Killer Contract Clauses

✔️ Lien Waivers
  - Pre-waiver of lien rights at signing of contract
    • Enforceable under Texas law
Practical Tools for Managing Onerous Contract Clauses

✔ Read the Contract
  – Find ambiguous terms or words
    • “May”
  – Imprecise terms
  – Indefinite scope
Practical Tools for Managing Onerous Contract Clauses

✓ Reasonable Approach

– Insert “reasonable” wherever other party is being heavy handed

• Tough for other side not to be reasonable
Practical Tools for Managing Onerous Contract Clauses

✓ Goose and Gander
  - What’s sauce for the Goose is sauce for the Gander
  - Use for other party’s assertion of some right
    • E.g., attorney’s fees and expert costs
Practical Tools for Managing Onerous Contract Clauses

✔ Daily Reports
  - Create listings for extra work, delay, start date, resources impacted (personnel, etc.), and resolution date
  - Circulate daily reports daily
Practical Tools to Manage Onerous Contract Clauses

✓ Check Legal Enforceability
  - Some heavy handed clauses are not legally enforceable
    • E.g., notice of claims in less than 90 days, or indemnity not meeting express negligence test
Practical Tools to Manage Onerous Contract Clauses

- Dispute Review Boards
  - Administrative response to change order problem solving
  - DRB can be binding or advisory
  - DRB is relatively low cost and fast
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Subcontract Language –
The Secrets Revealed

PCL Contract Bonding Agency
April 18, 2000

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Contracts for the Manager

Associated Builders and Contractors
February 10, 2000

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Avoiding Killer Clauses in Drafting Contracts

Associated Builders and Contractors
June 3, 1999

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