Entering into Construction Contracts and Subcontracts

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This article focuses on contracts for commercial construction, although many of the considerations discussed below also apply to residential construction.

Typical commercial construction contracts involve such a wide array of efforts to balance and shift risks of construction work, financial uncertainty, and potential for physical injury during the construction phase and thereafter, that negotiating and interpreting such contracts has become a cottage industry.

Construction contracts generally are written according to the theory that “he who has the gold makes the rules” and the hierarchy of risk shifting reflects this. That is, every party in the contracting chain, from the owner to the smallest sub-subcontractor, will seek maximum protection and minimum exposure to parties above and below it in the contracting chain. The location in this chain of a contracting party usually sets the boundaries of negotiation, performance, and liability for breach for any given project.

I. Understanding Contract Terminology

Contracts are written, performed, and enforced in the context of the industry in which the parties are working. Every industry has its own language, and the language of the construction industry includes a large number of seemingly ordinary words that have taken on special meaning in the business (“acceleration” and “change” are examples), acronyms (“OSHA” or “OCIP” or “GMP”), and legal terms (“indemnity” and “additional insured”).

Appendix A is a widely circulated list of construction terms compiled by Steve Nelson, an experienced contractor and construction lawyer. He was kind enough to allow us to use it for reference here.

II. Forming Contracts and Understanding Contract Obligations

A. Contract Documents

Construction contracts come in many forms, but almost all share a critical common feature: the document that will be presented for signature does not contain within its four corners all of the terms, conditions, specifications, and requirements that will apply to that contract. Instead, these terms will be supplied by a process known as “incorporation by reference,” and the whole is typically described as the “Contract Documents.” This definition will typically be phrased very broadly and will include documents that may not be readily accessible to lower tier parties, and will almost always involve terms and conditions which have been negotiated or agreed to by other parties and which therefore cannot be modified. As a result, the careful contractor will review these materials and ask for copies to be sure what deal is actually being struck.
Lump Sum Contracts. From a financial standpoint, a lump sum contract is probably the most risky to a contractor because of the prospect that costs may rise during the construction phase in excess of what the contractor anticipates. As a result, a contractor entering into a lump sum contract should seek some protection, either in the form of cost escalation provisions, including expected overhead and profit, protection from delays in the form of payment guarantees, or in the form of voluntary termination provisions.

Cost Plus Contracts. A cost plus contract shifts the risk of price increases to the owner from the contractor. Many parties agree to a variation of a cost plus contract that involves a “guaranteed maximum price” aspect. Under a GMP contract, the contractor agrees that the price will not exceed a set amount, and that any costs in excess of this are borne by the contractor. Many GMP contracts also contain a “savings clause” under which the difference between an expected price and the guaranteed maximum price is allocated between the contractor and the owner, thus providing the contractor with an incentive to control costs by the prospect of obtaining additional profit by sharing in the saved funds.

B. Contract Forms

The most widely used owner-general contractor forms are based on documents issued by the American Institute of Architects (AIA). The AIA has promulgated several forms that deal with variations in financial arrangements, such as lump sum or GMP, and other issues, including subcontracts, but the most “standard” provisions are those contained in the A201 General Conditions. The A201 General Conditions, if used, are defined as a “Contract Document” and contain provisions that deal with many of the issues discussed below, such as change orders, termination provisions, dispute resolution mechanisms, and similar issues. The General Conditions are revised on a ten-year basis, and the most recent form was released in 2007. As with many “form” documents, the provisions of the A201 are often negotiated between the owner and the general contractor, and these negotiations can have a substantial effect on lower tier contractors.

General contractors frequently use their own customized subcontract forms. Typically these forms incorporate the terms and conditions of the general contract between the owner and the general contractor, such as the A201 General Conditions. As a result, a relatively innocuous-appearing subcontract containing four or five pages may, through incorporation by reference of the Contract Documents, actually involve a much larger series of agreements than would appear to be the case at first blush.

C. The Role of Bidding in Contract Formation

Construction contracts generally begin with a bid by a contractor which, when accepted by the upstream party, forms the basis of the agreement. Particularly in the case of lower tier contractors, however, the terms of the agreement other than price and general scope of work are not negotiated, or perhaps not even known, until long after the upstream contractor has used the bid in its own efforts to secure the work. For example, if terms and conditions other than scope of work and price to be paid are not established, an argument could be made that a contractor is entitled to receive no payment until full completion of the work because provisions for periodic payments, although customary, have not been spelled out in the written documents. Therefore, it
is important for all parties to make agreements as to price and scope contingent on agreement as to other terms and conditions to avoid unexpected difficulties.

The general rule is that a contract must be in writing and signed by the opposing parties before a court will enforce it. This rule is generally referred to as the “Statute of Frauds,” but it has many exceptions. One of these exceptions applies if a party has made a proposal to another party and then withdraws that proposal after the party to whom it made the proposal has relied on it.

There is an exception to the Statute of Frauds in construction bid cases. *Frost Crushed Stone Co., Inc. v. Odell Greer Construction Co., Inc.*, 110 S.W.3rd 41 (Tex. App. —Waco 2002, no pet.), discussed this exception. In that case a subcontractor sued a supplier based on an oral bid for rock to be used on a highway project by the subcontractor. The general contractor accepted the subcontractor’s bid, based in part on the supplier’s bid. The supplier then told the subcontractor that it was unable to supply the rock as it had promised. The subcontractor then sued the supplier to recover the additional trucking costs it incurred after the supplier refused to perform, causing the subcontractor to haul the rock a longer distance.

The supplier argued that because there was no written contract, the subcontractor could not prove its case. The Court allowed recovery under the theory of “promissory estoppel”:

As is true in most, if not all, bid construction cases, the present situation does not involve a contract. Therefore, were we to hold that promissory estoppel does not exist in bid construction cases, this would necessarily mean that, notwithstanding any language or conduct by the subcontractor which leads the general contractor to do that which he would not otherwise have done and, thereby, incur loss or injury, the general contractor would be denied all relief. This proposition is untenable and conflicts with the underlying premise of promissory estoppel. Accordingly, we find that promissory estoppel is a viable cause of action in bid construction cases.

Damages in promissory estoppel cases are generally limited to “out of pocket” recovery, which generally means the difference between the bid made and the contract price that had to pay paid.

D. **Flow-Down Provisions**

“Flow-down” provisions can have two general effects. For the most part, they impose liabilities and responsibilities owed by an upstream party to another party on lower tier parties. For example, a flow-down provision may obligate a subcontractor to perform and assume all of the responsibilities that the general contractor owes to the owner, at least with respect to the subcontractor’s scope of work. This is a risk-shifting feature which requires the subcontractor to perform certain aspects of the agreement that the general contractor has agreed to perform.

Another aspect of a flow-down provision is to protect the owner directly. For example, flow-down provisions imposed by the owner may obligate the general contractor to require that all lower tier parties agree to certain obligations that the owner requires that may not be related
directly to construction of the project. A typical example is an obligation in a general contract
that all workers who participate in the construction of the project be eligible to work in the
United States. The owner does not have contracts with every party which will participate in the
construction and therefore has the ability to require this obligation only through the application
of flow-down provisions.

A typical broad form flow-down provision in a contract between an owner and a general
contractor is the following:

All agreements and contracts between Contractor and its Subcontractors shall
provide, and shall require the Subcontractors to cause all agreements and
contracts with Sub-subcontractors to provide, that the Subcontractor or Sub-
subcontractor, as the case may be, is subject to all of the terms and conditions of
this Contract, except to the extent expressly stated otherwise in the Contract
Documents.

This provision arguably makes the subcontractor liable for all of the obligations of the general
contractor contained in the general contract. A subcontractor seeking to limit its risk posed by
such an agreement would try to limit it to the obligations that pertain to the plans and
specifications pertaining to the subcontractor’s scope of work.

E. Plans and Specifications

Upstream parties may wish to impose the responsibility for the accuracy and
completeness of plans and specifications on downstream parties. Sometimes this can occur as a
result of flow-down provisions. A provision that limits such exposure is the following:

[Owner] warrants the sufficiency, adequacy and accuracy of plans and
specifications prepared by [Owner] and its consultants on the project.
[Contractor] expressly disclaims any responsibility, warranty or other duties with
respect to the sufficiency of the plans and specifications unless [Contractor]
actually recognizes any deficiencies prior to performing work and fails to report
the deficiencies to the [Owner].

F. Concealed Conditions

A “concealed conditions” provision can be negotiated to avoid the effect of unanticipated
costs and delays that can result if the field conditions vary from the reports provided to the
contractor. In Millguard v. McKee/Mays, 49 F.3d 1070 (5th Cir. 1995), a subcontractor sued a
general contractor for its additional costs incurred when it drilled piers for a foundation as a
result of wet soil conditions. The bid documents had provided a soils report which stated that the
soil was anticipated to be dry, but the bid documents also said that the soils report was not a part
of the contract documents. The court denied the subcontractor recovery because it held that the
soils report was not a contract document and therefore could not constitute a condition that
differed from the conditions shown in the drawings, specifications, or other contract documents.
The instructions to bidders said: “The report is not a warranty of subsurface conditions, nor is it
a part of the Contract Documents.”
A “Type I” condition is generally described as a condition that is different from what is indicated in the drawings, reports, or other contract documents, and a “Type II” condition is a condition which is unusual and not expected in the construction activities the subject of the agreement.

A “contractor oriented” provision that can provide protection is the following:

[Contractor] shall be entitled to a time extension and additional compensation for conditions at the site which differ from the conditions that [Owner] knew based upon its pre-bid above-ground site inspection. These varying conditions include any subsurface conditions (manmade or natural), archeological finds, endangered species of plants or animals or any other conditions that may cause delays or additional compensation to [Contractor] due to environmental, safety, health or legal restrictions.

A variation of this problem was involved in a Texas Supreme Court case decided last year. In *El Paso Field Services, L.P. v. Mastec North America, Inc.*, 389 S.W. 3d 802 (Tex. 2013), the Court reviewed a complaint by a subcontractor that it had to perform extra work because a survey was incomplete. The subcontractor, Mastec, signed a contract to replace an old pipeline. The owner engaged a surveying firm to map out the route. The map showed “the locations of 280 “foreign crossings” along the pipeline's right-of-way, including other pipelines, utilities, roads, rivers, canals, fences, wells, cables, and concrete structures.” Mastec bid on that survey and got the contract. During its performance it discovered an additional 794 crossings. It completed most of the work the job and then sued the owner for the alleged extra work. The jury awarded MasTec $4,763,890. The trial court overturned the verdict because the contract put the risk of site conditions on MasTec and the Supreme Court affirmed that decision.

G. *Insurance and “Additional Insured” Provisions*

In commercial construction contractors are usually required to insure other parties who will participate in the project by “additional insured” provisions. The provisions require the contractor to issue a certificate that names the other parties as insured parties on the contractor’s policy. Some require that the contractor’s policy be used as the first source of funds (a “primary” policy designation) even though the upstream party, such as the owner, may have much more insurance coverage than the contractor. These provisions differ from contract to contract and contractors are advised to engage insurance professionals to help them interpret their requirements and structure coverage to satisfy the contract obligations.

H. *Contingent Payment Provisions*

In 2007 a statute concerning contingent payment construction contracts was enacted. It is codified *TEX. BUS. & COM. CODE Ch. 56*. This has not previously been addressed in Texas by legislation.

Generally a “pay-when-paid” provision requires payment after the paying party receives funds, although in some cases the paying party may be forced to pay even though it has not received payment from an upstream party. In a contingent payment (sometimes described as
“pay if paid”) contract payment is required only if the paying party actually receives funds. The new statute modifies this in several respects.

The statute contains requirements which appear to be the result of an effort to balance the competing interests of the parties involved in major commercial construction projects. The discussion below will not describe the statute in great detail but will instead note some key provisions:

- Important definitions include the “obligor,” which is the party obligated to make payment; a “primary obligor,” generally referring to the owner; a “contingent payor,” meaning the party to a contract with a contingent payment clause that conditions payment on receipt of payment from another party; and “contingent payee,” which means a party to a contract with a contingent payment clause whose receipt of payment is conditioned on the contingent payor’s receipt of payment from another party.

In a simple case, the owner would be the “obligor,” the general contractor would be the “contingent payor,” and the subcontractor would be the “contingent payee.”

- The general rule provided by the statute is that a contingent payment clause cannot be enforced if the reason for nonpayment is that the contingent payor has breached its contract, unless that breach is caused by the breach of the contingent payee.

In the simple analysis, this would mean that the general contractor would have to pay the subcontractor even if it had not received funds from the owner, if the owner has not paid the general contractor because the general contractor had breached its contract. Otherwise the general contractor would not have to pay the subcontractor.

- Even if the contingent payment clause is enforceable, there is an exception for a contingent payee which gives notice of its intent not to be bound by the provision. The notice lapses on payment, so periodic notices are required.

- A contingent payor cannot enforce a contingent payment clause if it is in a “sham contract” relationship with the obligor.

- The statute says that it cannot be used to invalidate the perfection or enforcement of a mechanic’s and materialman’s lien.

- A contingent payment clause cannot be enforced if enforcement would be “unconscionable.” There is a safe harbor against a claim of unconscionability for a contingent payor if it (1) proves that it exercised diligence in ascertaining and communicating in writing to the contingent payee the financial viability of the primary obligor and the existence of adequate financial arrangements to make payment (such as providing copies of loan arrangements or surety information), and (2) makes an effort to collect the payment due to the contingent payee or offers to assign that claim to the contingent payee.
• The statute does not apply to a contract for (1) design services; (2) civil engineering construction such as highways, utilities, airports, or related projects; or (3) residential construction.

I. How to (Try to) Limit Liability

Although a contractor may not have the bargaining power to obtain substantial relief, some areas may be negotiated on occasion. Some suggestions are:

• Carefully state the scope of work.

• Ask insurance professionals for assistance in reviewing risk-shifting provisions, such as indemnity agreements, to make certain that insurance covers the risk involved.

• Obtain a commitment to attempt to mediate disputes, and consider arbitration rather than court resolution of disputes.

• Seek an agreed provision describing termination procedures, including allocation of costs.

• Be cautious of warranty provisions. Some provisions appear to promise perfection rather than reasonable professional skill, such as:

  The [contractor] warrants that all services rendered under this agreement shall be performed by persons who are extraordinarily skilled and in accordance with the highest standards of their profession. The [contractor] further warrants that all construction work performed on this project will conform to the plans and specifications and will be sufficient for the intended purpose.

At the completion of the project the [contractor] will certify that all of the work has been performed in strict accordance with the [owner’s] plans and specifications.

Not only are clauses like this a guarantee of perfect work, which cannot be obtained, but also they include a guaranty of the performance of the work of others.

• Contractors should ask for a broad limitation of liability provision that sets a limit of damages. An example is:

  In recognition of the relative risks and benefits of the project to both the Owner and the [contractor], the risks have been allocated such that the Owner agrees, to the fullest extent permitted by law, to limit the liability of the [contractor] and his or her subconsultants to the Owner and to all construction contractors and subcontractors on the project for any and all claims, losses, costs, damages of any nature whatsoever or claims expenses from any cause or causes, so that the total aggregate liability of the [contractor] and its subconsultants to all those named shall not exceed $_______, or the [contractor’s] total fee for services rendered on this
project, whichever is greater. Such claims and causes include, but are not limited to, negligence, professional errors or omissions, strict liability, breach or contract, or warranty.

- Perhaps the contractor could obtain a disclaimer of certain warranties. Proposed language is:

> [Contractor] does not warrant or guarantee any particular result from its services and specifically disclaims any warranties, express or implied, which may arise by statute, common law, or equity. The excluded warranties include but are not limited to, any implied warranty that work or professional services will be performed in a good and workmanlike manner, or an express warranty, written or oral, regarding either its services or the suitability of any of the Contract Documents.

- A contract provision that requires allocation of fault on a comparative basis might be used either on a stand-alone basis, or in an attempt to mitigate the harsh results of an indemnity clause. A suggested provision that provides for comparative fault is the following:

> Any liability of the [subcontractor] from a breach of this agreement, or for any other cause of action arising out of the breach of this agreement, shall be limited to those damages actually caused by the [subcontractor’s] breach and shall not include any liability for damages caused by the Contractor, the Owner, or other members of the construction team.

- The contractor should seek a waiver of consequential damages. In Texas consequential damages include lost profits, which can exceed liability insurance coverage. The following clause is provided by A201-1997:

> § 15.1.6 CLAIMS FOR CONSEQUENTIAL DAMAGES

The Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Contract. This mutual waiver includes

1. damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and
2. damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.

This mutual waiver is applicable, without limitation, to all consequential damages due to either party’s termination in accordance with Article 14. Nothing contained in this Section 15.1.6 shall be deemed to preclude an award of liquidated damages, when applicable, in accordance with the requirements of the Contract Documents.

- A final suggestion is to request a waiver of subrogation rights. Subrogation rights can arise when an insurance company pays a claim asserted against its insured, and then seeks recovery from another party. In the absence of a waiver, for example, a property owner could seek and recover damage from an insurance company of the contractor. The contractor’s insurance company, after paying the claim, then could
seek recovery of those funds under a subrogation theory from the design professional. Here is an example from the A201-1997:

§ 11.3.7 WAIVERS OF SUBROGATION
The Owner and Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and employees, each of the other, and (2) the Architect, Architect’s consultants, separate contractors described in Article 6, if any, and any of their subcontractors, sub-subcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Section 11.3 or other property insurance applicable to the Work, except such rights as they have to proceeds of such insurance held by the Owner as fiduciary. The Owner or Contractor, as appropriate, shall require of the Architect, Architect’s consultants, separate contractors described in Article 6, if any, and the subcontractors, sub-subcontractors, agents and employees of any of them, by appropriate agreements, written where legally required for validity, similar waivers each in favor of other parties enumerated herein. The policies shall provide such waivers of subrogation by endorsement or otherwise. A waiver of subrogation shall be effective as to a person or entity even though that person or entity would otherwise have a duty of indemnification, contractual or otherwise, did not pay the insurance premium directly or indirectly, and whether or not the person or entity had an insurable interest in the property damaged.

J. Delay Damages Provisions

Owners and upstream contractors may insist on a “no damage for delay” provision. If delays do occur which are attributable to parties other than the contractor, the contractor can be forced to stay mobilized for the job and incur significant costs without the ability to recover from a party which may have caused the delay. A provision that would reduce this risk, at least with the immediately contracting upstream party, is the following:

Neither party shall be liable to the other for delay in performance which is caused completely by that party. If [Contractor] is entitled to a time extension under other provisions of this agreement, and if the delay is not otherwise compensable under this agreement or by operation of law, [Contractor] shall nevertheless be entitled to an equitable adjustment of the contract sum if the delay impacts the critical path of the schedule in excess of ____ days.

III. The Law Governing Construction Contracts: the Uniform Commercial Code (UCC) and Applicable State Laws

As applicable to this article, the Uniform Commercial Code is an integrated body of statutes that generally apply to contracts for the sales of “goods” (movable items, as opposed to real estate). The UCC has been adopted in every state but Louisiana. Because it is almost identical in every state, court decisions from one state are often used as precedent in others states.

The UCC contains its own rules about contract formation, performance, and breach. We will discuss a few of these here. As with most contracts, however, after the contract is formed, the primary source for resolving differences between the parties is the language of the contract itself.
In addition to the UCC, there are other sources of law that are imposed by state laws that are not necessary uniform, such as statutes of limitations. Generally, the application of state law depends on where the project was located but this rule has many exceptions.

A. Contract Formation Under the UCC

The general rule as expressed in § 2.201 (statutory references will be to the Texas Uniform Commercial Code, TEX. BUS. & COM. CODE §§ 1.101-11.108, is that a contract must be in writing and signed by the person against whom it is sought to be enforced. There are many exceptions to this rule, however, and a few will be noted here.

1. Requirements of Signatures

Although the Code uses the term “signing,” there is no requirement that a hand-written signature bearing the name of the party sought to be charged appear in the document. The term “sign” is defined to include “any symbol executed or adopted by a party with present intention to authenticate a writing.” (Section 1.201(39)).

2. Requirements of Formality

The Code recognizes that contracts may be formed in a very informal fashion. For example, contracts may come into existence if one of the parties can show “conduct by both parties which recognizes the existence of such a contract.” (Section 2.204).

Many of the terms of the contract can be left open and a contract still can be found to exist. For example, price terms can be left for future specification, delivery terms can be left open, and remedies available if either party fails to perform can be left open.

Despite these rules which create flexibility, if the contracts specify the manner of acceptance, that the contract will be followed. For example, in Great American Sugar v. Lone Star Donut Co., 721 S.W.2d 510 (5th Cir. 1983), the seller sent a letter to the buyer stating “This letter is a written confirmation of our agreement. Please sign and return to me the enclosed counterpart of this letter signaling your acceptance of the above agreement.” The market then dropped precipitously and the buyer refused to take delivery. The court held that no contract was formed because the buyer did not sign and return the letter.

3. The Battle of the Forms

Contracting parties often exchange contract forms creating the “Battle of Forms” dispute. UCC § 2.207 adopts the following rules to handle this situation:

A firm acceptance of an offer creates a contract even though it states additional or different terms, unless the acceptance expressly states it is conditional on agreement to the additional terms.

If the additional terms are not treated as conditional, they are construed as proposals for additions to the contract, and between “merchants” the terms become a part of the contract unless
A similar rule governs with respect to the formation of contracts and provides an exception to the statute of frauds. The Code says that between “merchants,” a signature requirement is not necessary if a written confirmation of the contract is received by the other party, who fails to give written notice of its objection to the contents of the confirmation within ten days after it is received. Section 2.201(b).

**B. Contract Performance Under the UCC**

The general obligation of the seller is to deliver goods which meet the contract requirements, and the general obligation of the buyer is to pay for the goods delivered. The primary issues which arise in the forward contracting context involves the concepts of acceptance, rejection, and revocation.

There are restrictions on a buyer’s ability to object to goods which are tendered for delivery under a contract. In general, a buyer must accept the goods unless they are “rejected” or unless acceptance is “revoked.” Even if this occurs, however, the seller is given a chance to “cure.”

**Buyer’s acceptance.** A buyer is said to “accept” when the buyer—

1. After reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or
2. Fails to make an effective rejection (subsection (1) of section 2.602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or
3. Does any act inconsistent with the seller’s ownership; but if such act is wrongful as against the seller, it is an acceptance only if ratified by him. (UCC § 2.606(a)).

The right of a buyer to “reject” is specified in UCC § 2.601, which authorizes the buyer to reject the entire tendered delivery, “if the goods or the tender of delivery fail in any respect to conform to the contract.” There appear to be at least four conditions under which the buyer has the right to reject:

1. A non-conforming tender;
2. The absence of an effective cure by the seller;
3. The absence of an acceptance; and
4. The absence of a contract term prohibiting rejection.

It is more difficult under the Code to “revoke” acceptance than to “reject” acceptance. The reason is that revocation occurs after the buyer has possessed the goods for some time, and the possibility exists that the goods may change condition when in the buyer’s possession. Section 2.608 addresses revocation, and it provides:
(a) The buyer may revoke his acceptance of a lot or commercial unit whose
non-conformity substantially impairs its value to him if he has accepted it
(i) of the reasonable assumption that it’s non-conformity would be cured and
has not been seasonably cured; or
(ii) without discovery of such non-conformity if his acceptance was
reasonably induced either by the difficulty of discovery before acceptance or by the
seller’s assurances.

Revocation of acceptance must occur within a reasonable time after the buyer discovers
or should have discovered the ground for it and before any substantial change or condition of the
goods which is not caused by their own defects. It is not effective until the buyer notifies the
seller of it.

The case law appears to focus on timeliness in rejection and revocation cases. The rule is
that rejection or revocation of acceptance must occur within a “reasonable time” after delivery,
but this “reasonableness” factor means that many of the disputes must be decided in litigation.

The seller is given the right to “cure” a defective delivery. This right, spelled out in
UCC-2.508 is stated in the statute as follows:

Where any tender or delivery by the seller is rejected because it is non-
conforming, and the time for performance has not yet expired, the seller may seasonably
notify the buyer of his intention to cure and may then within the contract time make a
conforming delivery.

Where the buyer rejects a non-conforming tender which the seller had reasonable
grounds to believe would be acceptable, with or without money allowance, the seller
may, if he seasonably notifies the buyer, have a further reasonable time to substitute a
conforming tender.

This Code provision limits the buyer’s ability to reject a delivery, and allows the seller
another chance to fulfill its contract obligations.

C. Determining Applicable State Law

Determining which state’s laws govern a construction contract can sometimes be
difficult. Texas follows the rule that a choice of law in a contract is enforceable if the forum
named as the source of law has a reasonable relationship to the transactions. See Nexen Inc. v.
Gulf Interstate Eng’g Co., 224 S.W.3d 412, 419-420 (Tex. App.—Houston [1st Dist.] 2006), no
pet. “When the parties' contract includes a choice-of-law provision that selects the law of a
jurisdiction bearing a substantial relationship to the parties or their transaction, the parties'
contractual obligations are governed by the law chosen by the parties unless (1) there is a state
with a more significant relationship to the transaction, (2) applying the chosen law would
contravene a fundamental policy of that state, and (3) that state has a materially greater interest
in the determination of the particular issue.” CMA-CGM (Am.), Inc. v. Empire Truck Lines, Inc.,
416 S.W.3d 495, 507-508 (Tex. App.—Houston [1st Dist.] 2013)(citing, among others, DeSantis
v. Wackenhut Corp., 793 S.W.2d 670, 677 (Tex. 1990)). Therefore, while the parties’ freedom to
choose what jurisdiction’s laws will apply to their agreement is not unlimited, the Texas
Supreme Court has stated that enforcement of the parties’ reasonable choice of law advances the policy of protecting the parties’ expectations. See DeSantis v. Wackenhut Corp., 793 S.W.2d at 677.

This can be an important decision. If the state where a project is located has a different statute of repose than the law of the state which the contract chose, then the result of a dispute may be based entirely on this issue. See Nexen Inc. v. Gulf Interstate Eng’g Co., 224 S.W.3d at 426 (applying a provision in the parties’ contract which called for the application of Alberta, Canada laws and holding that Alberta’s statute of repose applied and barred the appellants’ claims).

Despite the general rule in Texas regarding the enforceability of choice of law provisions in contracts, Texas has a special statute that applies to construction projects that are built in Texas. Chapter 272 of the Texas Business and Commerce code, entitled, “Law Applicable to Certain Contracts for Construction or Repair of Real Property Improvements,” contains an exception to the general choice of law rule otherwise applicable to contracts in Texas. Pursuant to Section 272.001 of the Texas Business and Commerce Code, if a contract is “principally for the construction or repair of improvements to rural property located in this state,” and if the contract’s terms provide that the contract is subject to 1) the law of another state, 2) litigation in another state, or 3) arbitration in another state, then such provision in the contract is voidable by the party obligated by the contract to perform the construction or the repair. See Tex. Bus. & Comm. Code § 272.001. Section 272.002 further clarifies the applicability of Section 272.001 by stating that, for purposes of Chapter 272, “a contract is principally for the construction or repair of an improvement to real property located in this state if the contract obligates a party, as the party's principal obligation under the contract, to provide labor or labor and materials as a general contractor or subcontractor for the construction or repair of an improvement to real property located in this state.” See Tex. Bus. & Comm. Code § 272.002(a). Furthermore, in Texas, even the statute allowing parties to select a venue for actions later arising from a major transaction includes the caveat that the venue selection statute is not applicable where the agreement regarding venue is voidable under Chapter 272 of the Business and Commerce Code. See Tex. Civ. Prac. & Rem. Code Ann. § 15.020(d)(2); See In re Regal Energy L.L.C., 2013 Tex. App. LEXIS 11779, 10-11 (Tex. App.—Corpus Christi Sept. 19, 2013), no pet.

IV. Subcontract Formation and Administration

A. Subcontract Formation

The discussion in part I – III is applicable and will not be repeated here.

B. Change Orders and Extra Work

During the performance phase of the work a contractor may be asked, or instructed, to perform additional work that is outside the scope of work of the original contract. Almost all contracts will provide that no claims for extra work will be permitted without a written change order from the owner or a written agreement between the parties. Agreements of this nature are enforceable but there are exceptions to this rule created by the courts, such as waiver, breach of contract by the owner in providing accurate plans and specifications which resulted in the change, a common-law claim for “quantum meruit,” and subsequent oral contracts that are
enforceable standing on their own. The exceptions may be enforced by courts or arbitrators if the parties failed to follow the written provisions of the contract. Contractors are advised to review these provisions carefully and follow them as strictly as possible and to submit documents even if the other party refuses to sign them, in order to create a “paper trail” of efforts to comply.

C. Lien Waivers

During the payment application process contractors are usually required to sign lien waivers as a condition of receiving payment. Texas common law traditionally held that the right to assert a mechanic’s or materialmen’s lien could be waived. See, e.g., Shirley-Self Motor Co. v. Simpson, 195 S.W.2d 951 (Tex. Civ. App.—Fort Worth 1946, no writ); San Antonio Bank & Trust Co. v. Anel, Inc., 613 S.W.2d 55, 59 (Tex. Civ. App.—Texarkana 1981, writ ref’d n.r.e.).

The enforceability of waivers was analyzed on the basis of whether an express agreement to waive a lien existed or could be implied from acts inconsistent with the continued existence of rights under the lien. McBride v. Beakley, 203 S.W. 1137, 1138 (Tex. Civ. App.—Amarillo 1918, no writ); see, e.g., El Paso Dev. Co., 769 S.W.2d at 589. Parties were not found to have intentionally waived a lien unless the was “very plain and clear.” The presumption under the common law was against waiver. Milburn v. Athans, 190 S.W.2d 388, 392 (Tex. Civ. App.—Fort Worth 1945, writ dism’d).

However the Texas Legislature enacted a statute that governed the waiver of mechanic’s and materialmen’s liens. For contracts entered into after January 1, 2012, purported waivers of mechanic’s and materialmen’s liens are unenforceable unless they are executed in accordance with Chapter 53 of the Texas Property Code. TEX. PROP. CODE § 53.281. This Chapter provides that a waiver and release releases the owner, the owner’s property, the contractor, and the surety on a payment bond from claims and liens only if: (1) the waiver and release substantially complies with the forms in TEX. PROP. CODE § 53.284; (2) the waiver and release is signed by the claimant or the claimant’s authorized agent and notarized; and (3) in the case of a conditional release, evidence of payment to the claimant exists.

TEX. PROP. CODE § 53.284 provides form language to be used for the following: a conditional waiver and release in exchange for or to induce the payment of a progress payment; an unconditional waiver and release to prove the receipt of good and sufficient funds for a progress payment; a conditional waiver and release in exchange for or to induce the payment of a final payment; and an unconditional waiver and release to prove the receipt of good and sufficient funds for a final payment. Copies of sample forms are attached as part of Appendix B.

These conditions on enforceability do not apply to “written agreements to subordinate, release, waive, or satisfy all or part of a lien or bond claim in: 1) an accord and satisfaction of an identified dispute; 2) an agreement concerning an action pending in any court or arbitration proceeding; or 3) an agreement that is executed after an affidavit claiming the lien has been filed.” Tex. Prop. Code § 53.287.
V. Performance and Payment Issues

A. Prompt Payment Statute

The Texas Prompt Payment Statute is set out at Tex. Prop. Code Ann. ch. 28. It requires an owner who has received a written payment request from a contractor to make payment of amounts for properly performed work or properly delivered materials to make payment not later than the 35th day after the date the owner receives the request. Similarly, it requires a contractor or subcontractor who receives payment to pay each of its subcontractors the portion of the payment, including any applicable interest, that is attributable to work properly performed or materials delivered by that subcontractor as provided under the contract. See Tex. Prop. Code Ann. § 28.002(b)-(c).

However, there is an exception to this prompt payment requirement in the event of a good-faith dispute. Section 28.003 allows an owner, contractor or subcontractor to withhold a certain amount from the disputed payment if a good faith dispute exists concerning its obligation to pay or the amount owed. Further, Section 28.003 clarifies that “a good faith dispute includes a dispute regarding whether the work was performed in a proper manner.”

If it is determined that an owner, contractor, or subcontractor has failed to pay an amount required under the Prompt Payment Statute, and if the good-faith exception does not apply, then the claimant may be able to recover interest on the amount wrongfully withheld. The statute allows interest to accrue at the rate of 1-1/2 percent per month beginning on the date that payment is due, and allows the recovery of attorneys’ fees in a case brought to enforce a claim under the statute. See Tex. Prop. Code Ann § 28.004. Title 304 of the Texas Finance Code also contains provisions regarding the accrual of judgment and prejudgment interest.

It should be noted that this Prompt Payment Statute in Chapter 28 of the Texas Property Code applies to private construction projects. If a construction contract with a governmental entity is involved, then Chapter 2251 of the Texas Government Code should be consulted for the requirements for payments for work performed or for materials delivered in connection with the contract and the interest provisions applicable thereto.

B. Payments to Downstream Parties/Lenders/Trust Fund Statute

Contractors frequently find themselves in the position of a middleman, receiving payment from one party and then providing payment to another. There are at least two obligations of a contractor to use funds in this fashion. The first will be found in contract documents, such as the contract itself, or in payment applications, which may direct the contractor to pay bills for the project from the funds that the contractor is receiving. The second source of this obligation in Texas is at Chapter 162 of the Property Code, which contains the trust fund statute. Under this law all monies paid to a contractor or a subcontractor under a construction contract and all loans received by a contractor or subcontractor, or owner, for the improvement of real estate are “trust funds” for the benefit of the persons who furnish labor or materials. In residential cases a contractor is required to maintain separate accounts for each project. Although contract documents might require this, the statute does not require this in the case of commercial construction. A contractor can defend a claim that it has violated the trust fund statute if it shows that funds were used to pay its “actual expenses directly related to the construction or repair of
the improvement.” Case law adopts a fairly generous view of this. For example, overhead expenses can be paid with construction trust funds as long as they were actually incurred and necessary to obtain or complete the project. Lively v. Carpet Servs., Inc., 904 S.W.2d 868, 876 (Tex. App.—Houston [14th Dist.] 1995, pet. denied).

Another situation in which a problem can be encountered occurs when a contractor grants a security interest in its accounts receivable to a lender. The trust fund statute does not apply, under its terms, to a lender, title company, closing agent, or payment bond surety. TEX. PROP. CODE ANN. § 162.002. The Texas Supreme Court has held that a bank’s perfected lien on a contractor’s accounts receivable has priority over the claims of subcontractors and suppliers which fail to perfect their mechanic’s liens. Republic Bank Dallas, N.A. v. Interkal, Inc., 691 S.W.2d 605 (Tex. 1985). (After the Interkal case was decided, the mechanic’s lien statute (TEX. PROP. CODE ANN. § 53.151(a)) was amended to provide that subcontractors, suppliers, and mechanics obtain a priority interest in funds over other general creditors). In re Waterpoint Int’l LLC, 330 F.3d 339 (5th Cir. 2003), held that Section 53.151 protected subcontractors, laborers and materialmen which had perfected their lien rights, but not otherwise.

Although a discussion of the mechanic’s and materialman’s lien statutes is outside the scope of this article, contractors are advised to protect their right to payment through compliance with the lien laws, which can offer assurance of payment not only from the owner’s property, by the creation of an enforceable lien, but also against parties which have an interest in the receivable itself.

VI. Breach of Contract and Default

A. Liquidated Damages

A liquidated damages provision, also known as a “stipulated damage” provision, is enforceable when damages are enforceable and the stipulated damage sum is reasonable, but if not, the provision is considered to be a “penalty” and will not be enforced. Phillips v. Phillips, 820 S.W.2d 785 (Tex. 1991). Courts use various factors to determine whether an agreement is enforceable, including: (1) whether the sum represents a good-faith estimate of potential damages at the time the contract is signed; (2) whether the liquidated damages provision was negotiated; (3) whether the harm caused by the breach of contract is incapable or difficult of estimation; (4) whether the amount of stipulated damages is a reasonable forecast of just compensation.

Most liquidated damages provisions relate to a contractor’s failure to achieve substantial completion by a stated deadline.

Subcontractors and lower tier parties need to be wary of liquidated damage provisions that may be imposed as a result of flow-down provisions and indemnity agreements, as well as liquidated damage provisions that may be a part of their own contract.

If liquidated damage provisions are included, a contractor may be able to negotiate an incentive for early completion to offset the risk of imposition of damages for late completion.
B. Notice of Claims

Many contracts contain very short time periods for a contractor to provide notice of claims, and provide the notice in particular forms and to particular parties. Although courts generally hold that a party which breaches its contract first cannot rely on such requirements, contractors are always better off by providing the notices required. The notice requirements cannot be satisfied without knowledge of what they require, so the contractor is advised to read these requirements carefully.

C. Work Continuation Requirements

Contracts often contain provisions that state the conditions under which a contract can suspend performance. Some of these require the contractor to continue to work even if claims are outstanding and the contractor is not receiving payment as a result. Contractors should consider requesting a provision that will obligate the party paying it to continue to make some payments even if a dispute arises, so that the contractor is not required to continue to work while the upstream party withholds all payment. A provision that addresses this situation is the following:

\[
\text{The \{Contractor\} shall continue to perform its obligations under this agreement pending resolution of any dispute, and the Owner shall continue to make payments of all amounts due the \{Contractor\} which are not in dispute.}
\]

The Prompt Payment Statute, mentioned above, also contains a provision that allows a contractor to suspend performance if the contractor is not paid within 36 days after it has given the notice required by the statute. In order for the contractor to be protected by this suspension of work provision, the contractor must give notice to the owner and, in some cases, the lender of its intention to suspend performance. There is an exception for a good-faith dispute, and the statute expressly does not apply to contracts to construct or improve residences or to improve real property for a governmental entity.

D. Indemnity

Effective January 1, 2012, a new Texas statute became effective that limited owners and upstream contractors from shifting the risk of their own negligence or breach of contract to subcontractors.

Section 151.102 of the Texas Insurance Code will now provide that “a provision in a construction contract … is void and unenforceable … to the extent that it requires an indemnitor to indemnify, hold harmless, or defend a party, including a third party, against a claim caused by the negligence or fault … of the indemnitee, its agent or employee, or any third party under the control or supervision of the indemnitee …” The new law further voids additional insurance requirements to the extent such requirements would protect an owner or upstream contractor from the consequences of their own negligence.

The statute contains exceptions, including claims brought by an employee of a subcontractor. This will allow a general contractor to continue to protect against claims brought by injured persons who are barred from suing their own employer. There are other exceptions
for homebuilders, municipal projects, oil and gas projects and railroad work. These groups already have laws in effect, however, which may achieve similar purposes.

The statute eliminated the so-called “broad-form” or “sole negligence” indemnifications which were standard in many Texas subcontractor agreements, as well as the narrower “concurrent indemnification” provisions.

E. Termination for Convenience

It is relatively common for general contracts and subcontracts to contain provisions that set a formula for damages if the upstream party terminates the downstream party’s contract for a reason unrelated to the downstream party’s breach. A sample provision is reproduced here:

Contractor may terminate this Agreement at any time without cause, by giving Subcontractor notice of its intent to terminate under this paragraph. If Contractor terminates under this paragraph before Subcontractor has begun the Work, Contractor shall pay reasonable mobilization costs, if any, incurred by Subcontractor. If Contractor terminates under this paragraph after Subcontractor has begun the Work, Subcontractor shall be entitled to receive as full compensation payment of all proper invoices submitted before the effective date of the notice of intent to terminate, payment on a percentage of completion basis from the date of the most recent invoice to the date of the notice, and payment on a time and materials basis for the time between the date of the notice and the termination. All requests for payment under this paragraph must be properly and fully documented as if submitted under the other terms and conditions of this Agreement. Subcontractor shall not be entitled to compensation for termination without cause calculated on any basis other than as specified in this paragraph.

Although the provision provides the downstream party with some compensation as a result of the failure to have the opportunity to complete the work, it does not provide payment for lost profits on the whole job. A problem that is not addressed by this provision concerns the terminated party’s liability to third parties, such as its subcontractors and suppliers. A contractor faced with a provision like this one should make certain that it has similar language in its subcontracts and supply arrangements to avoid claims for lost profits or damages the sub-subcontractor suffered because it was unable to perform its contract.

F. Statutes of Limitations and Repose

Statutes of limitations set time periods within which lawsuits must be brought after the right to bring them has “accrued” (begins to run). This occurs when a wrongful act causes an injury, regardless of when the plaintiff learns of the injury. The applicable statute of limitations depends on the nature of the claim that is asserted and who is asserting it. In Texas, generally claims for personal injuries or for property damages must be brought within two years after the claims accrue. Claims for breach of contract or to recover debt must be brought within four years after the claims accrue.
It appears to be generally accepted that parties can agree by contract when a cause of action accrues. For example, Article 13.7 of the AIA 201 General Conditions has separate accrual provisions for “acts or failures to act” before substantial completion, between substantial completion and final payment, and after final payment. It is also possible to agree to the time period that suit can be brought, although in Texas an agreement that establishes a limitations period that is shorter than two years is void. TEX. CIV. PRAC. & REM CODE ANN. §16.070.

It is not safe to assume that a tort claim must be brought within two years after the date that a project is completed. A concept known as the “discovery rule,” which applies in tort cases, might apply to extend the accrual date of a statute of limitations. For example, an owner might be able to assert that it did not know and could not with the exercise of reasonable diligence have discovered a design defect until a failure occurred, and thereby attempt to extend the accrual date for limitations to the date of actual discovery. See M.D. Thomson v. Espey Huston & Associates, Inc., 899 S.W.2d 415 (Tex. App.—Austin 1995, no writ).

The nature of construction is such that a possible defect could remain hidden for many years until an injury results, meaning that a cause of action might not accrue for years after construction has been completed. In an effort to protect contractors and design professionals from never-ending liability, the Texas legislature has enacted a “statute of repose.” This statute, at TEX. CIV. PRAC. & REM. CODE § 16.008, says that a cause of action for wrongful death, personal injury or property damage that arises out of a defective or unsafe condition of any real property must be commenced within ten years after substantial completion of the improvement or commencement of operation of any equipment attached to real property. If the claimant gives written notice of the claim within the ten-year period, however, the filing period is extended for two years from the date of that notice.

The effect of a statute of repose is to cut off a right to bring a claim that otherwise could be filed. After the time period set by the statute of repose expires, no cause of action can be brought for injuries or property damage resulting from damages caused by the unsafe premises.

There is a difference in the statute that protects design professionals and contractors. The statute that protects contractors, Remedies Code § 16.009, does not apply if “willful misconduct or fraudulent concealment in connection with the performance of the construction or repair” has occurred. This provision does not exist in the statute that protects design professionals. In Dallas Market Center Development Co. v. Beran & Shelmire, 824 S.W.2d 218 (Tex. App.—Dallas 1991, writ denied), the court held that an allegation that a design firm committed fraudulent concealment did not extend the ten-year period set by the statute of repose, based on this distinction and the language of the statutes. The design professional is cautioned to take this into account when being asked to indemnify contractors.

In addition, the statute of repose does not protect an unregistered or unlicensed design professional who is required to be registered and licensed. Sometimes it is not clear whether the professional, even if registered, is entitled to receive the protection of the statute of repose. For example, in Kazmir v. Suburban Homes Realty, 824 S.W.2d 239 (Tex. App.—Texarkana 1992, writ denied), a home builder (Suburban Homes Realty) was sued by homeowners for negligence, common law and statutory fraud, and DTPA violations under the theory that Suburban Homes sold the residences while concealing the fact that they were on or near an active geological fault. Suburban Homes moved for summary judgment based on the statute of repose under the theory
that one of its officers and a part owner performed engineering services. The court said that a
firm did not need to provide engineering services exclusively to be protected by the statute, but
then said that “the mere fact that a firm or company has a person in its employ who is an
ingenue does not make the firm an engineer within the meaning of Section 16.008.” The
question of whether the firm is entitled to the protection of the statute is one the court will decide
based on such factors as what the firm’s principal business is (in Kazmir the court looked at tax
returns to determine whether income was primarily received from real estate sales or from
engineering services), insurance policies describing the business, advertising, and the
engagement of other design professionals for specific work.

G. Arbitration

Many construction disputes are governed by arbitration agreements. A few
considerations on this topic are stated below.

1. Major Procedural Differences Between and Litigation and Arbitration

Although litigation and arbitration are closely related, there are major procedural
differences that can cause significant differences in result, expense, time of resolution and other
considerations, such as:

- The rules that permit joinder of parties in arbitration are much more restrictive
  that those in litigation.
- The elaborate rules that allow appeals from virtually every aspect of a court trial
  are almost non-existent in challenges to arbitrations.
- Discovery is usually much more limited in arbitration than in court cases.
- The parties usually have some flexibility in choosing arbitrators but little choice
  of judges.
- The place where the arbitration occurs may be different from the place where the
court case to foreclose the lien is located.

As a result of these and other differences, parties often spend much time and money
arguing whether the merits of the dispute should be decided by a judge or an arbitrator before
they ever get to the substance of the dispute.

2. Rules for Determining Whether an Agreement to Arbitrate Exists

The general rule is that a party must agree to arbitrate before it is bound to do so.
Deciding this can be a difficult issue in a construction case. Construction contracts come in
many forms, but almost all share a common feature: the document that will be presented for
signature does not contain within its four corners all of the terms, conditions, specifications, and
requirements that will apply to that contract. Instead, these terms will be supplied by a process
known as “incorporation by reference” and the whole is typically described as the “Contract
Documents.” This definition will typically be phrased very broadly and will include documents
that may not be readily accessible to lower tier parties, and will almost always involve terms and conditions that have been negotiated or agreed to by other parties and which therefore cannot be modified. As a result, all of these documents must be reviewed and considered before making a decision about whether to proceed with litigation or arbitration.

For example, in *In re Premont Indep. School District* 225 S.W.3d 329 (Tex. App. — San Antonio 2007, orig. proceeding) the Court of Appeals had to decide a “reverse” incorporation by reference case. In that case the school district sued its construction manager for delays and defective work. The manager asserted a contractual right to arbitrate but the trial court denied the motion. On appeal the school district argued that there was no arbitration agreement because although the A121 contract incorporated section 4.5 of the A201 (containing the arbitration clause), the parties had adopted a supplementary condition striking that section. The construction manager argued that the supplementary conditions were not signed and therefore the arbitration clause was still valid. The Court of Appeals held that "an arbitration agreement that is not signed may be incorporated by reference in the signed contract .... Likewise, an agreement to not arbitrate that is not signed may be incorporated by reference in the signed document." Because the contract documents did not require the supplementary conditions to be signed the Court of Appeals held that no valid arbitration agreement existed.

3. Whether a Court or an Arbitrator Decides Whether an Agreement to Arbitrate Exists

Whether an agreement to arbitrate exists involves two inquiries, although this is referred to as the single concept of “arbitrability.” The Supreme Court’s decision in *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995), discussed this point: “This determination [whether there is an agreement to arbitrate] depends on two considerations: (1) whether there is a valid agreement to arbitrate between the parties; and (2) whether the dispute in question falls within the scope of that arbitration agreement.” The question of who decides these questions (arbitrator or judge) can be critical.

Parties are free to agree that an arbitrator may decide whether an agreement to arbitrate exists. But if there is no “clear and unmistakable evidence” of the parties’ intention to have the arbitrator decide that issue, a reviewing court does so. *Kaplan, supra.* This means that a participant in an arbitration who has not agreed to submit the question of arbitrability to the arbitrator can later argue the point in court without waiving its right to independent court review, so long as it objects to jurisdiction during the arbitration proceeding. *Id.* at 946.

*First Options of Chicago v. Kaplan* also discussed that issue. It noted that if parties to a contract agree to allow the arbitrator to decide the issue of arbitrability the decision of the arbitrator is reviewable under traditional standards of review of arbitration decisions. On the other hand, if a party does not agree to arbitrability, it is entitled to an independent review of the issue by the courts. This flows “from the fact that arbitration is simply a matter of contract between the parties: it is a way to resolve those disputes—but only those disputes—that the parties have agreed to submit to arbitration.” *Kaplan*, 514 U.S. at 943.
4. Exceptions to Signing Requirement

In *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732 (Tex. 2005), the Texas Supreme Court considered whether a non-signatory to an arbitration agreement could be compelled to arbitrate. The Court in *Kellogg* recognized the following six exceptions to the general rule that non-signatories are not obligated to arbitrate because they have not agreed to arbitrate:

Federal courts have recognized six theories that, arising out of common principles of contract and agency law, may bind non-signatories to arbitration agreements: (1) incorporation by reference; (2) assumption; (3) agency; (4) alter ego; (5) equitable estoppel; and (6) third-party beneficiary.

These rules can require a party that did not sign an arbitration agreement, such as a subcontractor, to arbitrate its disputes if it agreed to be bound to all provisions of a contract that was incorporated by reference into its subcontract which contained an arbitration provision.

5. Who Are the Proper Parties to an Arbitration

Because of the rule that a party seeking to compel arbitration must show the existence of an arbitration agreement and show that the claims asserted fall within the scope of that agreement [See *Cappa Donna Elec. Mgt. v. Cameron County (In re Cappadona Elec.),* 180 S.W.3d 364 (Tex. App. — Corpus Christi 2005, org. proceeding)], a question frequently arises whether third-parties may be joined to an existing arbitration proceeding. If there are exceptions to this rule (incorporation by reference, assumption, agency, alter-ego, equitable estoppel, third-party beneficiary, and direct benefit estoppel cited above), the third-party cannot be joined.

An issue of particular interest concerns whether sureties on performance bonds may be joined. Several cases have allowed this to occur if the bond incorporates the terms of the bonded contract by reference, under the “incorporation by reference” theory. *J.S. & H. Construction Co. v. Richmond County Hospital Authority,* 473 F.2d 212 (5th Cir. 1973).
Acknowledgments

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- “What Form Agreements Are Currently Being Used to Retain Architects and Engineers and What Amendments Should Be Required or Accepted,” Richard A. Capshaw, 18th Annual Construction Law Conference, March 3 and 4, 2005.


- Sandra K. Webb, J.D., LL.M., Amarillo, Texas.

- Stan Nabors, Information Systems, Inc., Austin, Texas

- Shifting Risk and Liability Exposure through Contract “Language: A Litigator’s Perspective,” Benton J. Barton, Hall & Evan, LLC (2011)

- Glossary of Construction Law, Construction Insurance, and Surety Industry Terms (Steve Nelson)
Appendix A

Attached
Appendix B

Attached
[NOTE: Texas Property Code § 53.284(b): If a claimant or potential claimant is required to execute a waiver and release in exchange for or to induce the payment of a progress payment and is not paid in exchange for the waiver and release or if a single payee check or joint payee check is given in exchange for the waiver and release, the waiver and release must read:]

**CONDITIONAL WAIVER AND RELEASE ON PROGRESS PAYMENT**

Project ___________________
Job No. ___________________

On receipt by the signer of this document of a check from ________________ (maker of check) in the sum of $__________ payable to ________________ (payee or payees of check) and when the check has been properly endorsed and has been paid by the bank on which it is drawn, this document becomes effective to release any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position that the signer has on the property of ________________ (owner) located at ______________________ (location) to the following extent: ____________________ (job description).

This release covers a progress payment for all labor, services, equipment, or materials furnished to the property or to ________________ (person with whom signer contracted) as indicated in the attached statement(s) or progress payment request(s), except for unpaid retention, pending modifications and changes, or other items furnished.

Before any recipient of this document relies on this document, the recipient should verify evidence of payment to the signer.

The signer warrants that the signer has already paid or will use the funds received from this progress payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above referenced project in regard to the attached statement(s) or progress payment request(s).

Date ____________________________
_________________________________(Company name)

By: ______________________________
Name: _____________________________
Title: _____________________________
STATE OF ________________  )
COUNTY OF ________________  ) ss:

The foregoing instrument was acknowledged before me this _____ day of
__________, 20___ by ______________, as ___________ of
__________________, on behalf of the company. He/She is personally known to me or
produced a valid driver's license as identification.

______________________________
Notary Public
Print name: _______________________

My commission expires:
______________________________
NOTE: Texas Property Code § 53.284(c): If a claimant or potential claimant is required to execute an unconditional waiver and release to prove the receipt of good and sufficient funds for a progress payment and the claimant or potential claimant asserts in the waiver and release that the claimant or potential claimant has been paid the progress payment, the waiver and release must contain a notice at the top of the document, printed in bold type at least as large as the largest type used in the document, but not smaller than 10-point type, that reads as follows and below the notice, read as follows:

NOTICE:

THIS DOCUMENT WAIVES RIGHTS UNCONDITIONALLY AND STATES THAT YOU HAVE BEEN PAID FOR GIVING UP THOSE RIGHTS. IT IS PROHIBITED FOR A PERSON TO REQUIRE YOU TO SIGN THIS DOCUMENT IF YOU HAVE NOT BEEN PAID THE PAYMENT AMOUNT SET FORTH BELOW. IF YOU HAVE NOT BEEN PAID, USE A CONDITIONAL RELEASE FORM.

UNCONDITIONAL WAIVER AND RELEASE ON PROGRESS PAYMENT

Project ___________________
Job No. ___________________

The signer of this document has been paid and has received a progress payment in the sum of $___________ for all labor, services, equipment, or materials furnished to the property or to ______________________ (person with whom signer contracted) on the property of ______________________ (owner) located at ______________________ (location) to the following extent: ________________ (job description). The signer therefore waives and releases any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position that the signer has on the above referenced project to the following extent:

This release covers a progress payment for all labor, services, equipment, or materials furnished to the property or to ______________________ (person with whom signer contracted) as indicated in the attached statement(s) or progress payment request(s), except for unpaid retention, pending modifications and changes, or other items furnished.

The signer warrants that the signer has already paid or will use the funds received from this progress payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above referenced project in regard to the attached statement(s) or progress payment request(s).

Date ____________________________

_________________________________

(Company name)
The foregoing instrument was acknowledged before me this _____ day of __________, 20___ by ______________, as __________________ of ________________, on behalf of the company. He/She is personally known to me or produced a valid driver's license as identification.

______________________________
Notary Public

My commission expires:
______________________________
[NOTE: Texas Property Code § 53.284(d): If a claimant or potential claimant is required to execute a waiver and release in exchange for or to induce the payment of a final payment and is not paid in good and sufficient funds in exchange for the waiver and release or if a single payee check or joint payee check is given in exchange for the waiver and release, the waiver and release must read:]

**CONDITIONAL WAIVER AND RELEASE ON FINAL PAYMENT**

Project ___________________
Job No. ___________________

On receipt by the signer of this document of a check from ________________ (maker of check) in the sum of $____________ payable to ________________ (payee or payees of check) and when the check has been properly endorsed and has been paid by the bank on which it is drawn, this document becomes effective to release any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position that the signer has on the property of _____________________ (owner) located at ______________________ (location) to the following extent: ____________________ (job description).

This release covers the final payment to the signer for all labor, services, equipment, or materials furnished to the property or to ____________________ (person with whom signer contracted).

Before any recipient of this document relies on this document, the recipient should verify evidence of payment to the signer.

The signer warrants that the signer has already paid or will use the funds received from this final payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above referenced project up to the date of this waiver and release.

Date ____________________________
_________________________________
(Company name)

By: _____________________________
Name: ___________________________
Title: ___________________________

STATE OF ____________________   )  
COUNTY OF ____________________  ) ss:

The foregoing instrument was acknowledged before me this _____ day of
__________, 20___ by ______________, as ___________ of
__________________, on behalf of the company. He/She is personally known to me or
produced a valid driver's license as identification.

_________________________________________
Notary Public
Print name: ________________________________

My commission expires:
_________________
[NOTE: Texas Property Code § 53.284(e): If a claimant or potential claimant is required to execute an unconditional waiver and release to prove the receipt of good and sufficient funds for a final payment and the claimant or potential claimant asserts in the waiver and release that the claimant or potential claimant has been paid the final payment, the waiver and release must contain a notice at the top of the document, printed in bold type at least as large as the largest type used in the document, but not smaller than 10-point type, that reads as follows and below the notice, read as follows:]

NOTICE:

THIS DOCUMENT WAIVES RIGHTS UNCONDITIONALLY AND STATES THAT YOU HAVE BEEN PAID FOR GIVING UP THOSE RIGHTS. IT IS PROHIBITED FOR A PERSON TO REQUIRE YOU TO SIGN THIS DOCUMENT IF YOU HAVE NOT BEEN PAID THE PAYMENT AMOUNT SET FORTH BELOW. IF YOU HAVE NOT BEEN PAID, USE A CONDITIONAL RELEASE FORM.

UNCONDITIONAL WAIVER AND RELEASE ON FINAL PAYMENT

Project ___________________
Job No. ___________________

The signer of this document has been paid in full for all labor, services, equipment, or materials furnished to the property or to __________________ (person with whom signer contracted) on the property of __________________ (owner) located at __________________ (location) to the following extent: __________________ (job description). The signer therefore waives and releases any mechanic's lien right, any right arising from a payment bond that complies with a state or federal statute, any common law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the signer's position.

The signer warrants that the signer has already paid or will use the funds received from this final payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above referenced project up to the date of this waiver and release.

Date ____________________________

_________________________________
(Company name)

By: _____________________________
Name: ___________________________
Title: ___________________________
STATE OF _____________________  )
COUNTY OF _____________________  ) ss:

The foregoing instrument was acknowledged before me this _____ day of
__________, 20___ by __________________, as ___________ of
__________________, on behalf of the company. He/She is personally known to me or
produced a valid driver's license as identification.

______________________________
Notary Public
Print name: ________________________

My commission expires:

__________