

CONSTRUCTION LAW DEVELOPMENTS:

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RECENT DEVELOPMENTS IN TEXAS CONSTRUCTION LAW

INTRODUCTION

This paper¹ is a summary of recent judicial decisions and other developments that have an impact on construction law. As with all such surveys, the classification of “significant” is with the author. There were no major mechanics' lien or bond claim decisions during the survey period, and I have not covered pending legislation. There are several bills impacting the construction industry, including SB 346 which would make indemnity agreements void to the extent they covered sole or partial negligence of an indemnitee. It and its companion bill, H2262, would also prohibit additional insured status or waivers of subrogation that contravene the intent of the statute.

I. ARBITRATION

The frequent use of arbitration in construction contracts continues to generate many decisions. However, with minor exceptions, the lessons remain constant. Arbitration clauses will be enforced and awards will seldom be set aside, except for a rare case of an arbitrator's failure to disclose grounds.

A. CHALLENGE TO CONTRACT AS A WHOLE IS FOR ARBITRATORS—NOT COURTS

In *Buckeye Check Cashing, Inc. v. Cardegna*,² the U.S. Supreme Court held that when a contract includes an agreement to arbitrate, the validity of the contract as a whole is a question to be decided in arbitration. In *Buckeye*, a group of consumers alleged that Buckeye charged usurious interest rates in connection with check cashing loans and that the underlying loan agreements were illegal under Florida law. The consumers argued that because the loan agreements were illegal and, therefore, void entirely, the arbitration clause within the agreement was also void. The Supreme Court disagreed and held that questions regarding the validity of the contract are reserved for the arbitrator, while questions regarding the formation of the contract, i.e. agency, capacity, etc., are appropriate for the court to decide.

Following *Buckeye*, a U.S. federal district court in Florida recently held that a challenge to the validity of a contract, containing a mandatory arbitration clause, is for arbitrators to decide.³ In reaching this decision, the court cited the *Buckeye* opinion as being directly on point. The court reasoned that since the parties challenged the validity of the agreement, and not the arbitration clause itself, the challenge must go to the arbitration.⁴

¹ Portions of this paper are from the 2006 Supplement to Texas Construction Law Manual, 3rd ed. (J. Canterbury and R. Shapiro) Thompson West, 2005 and a paper written and presented with William Allensworth entitled, Construction Law Update, for the 20th Construction Law Conference of the Construction Law Section of the State Bar of Texas in March 2007.

² 546 U.S. 440, 126 S. Ct. 1204 (2006).

³ *Quest Communications Corp. v. Ansari*, No. 05-1836, 2007 WL 172318 (D.D.C., Jan. 23, 2007).

⁴ *Id.* at *2, (citing, *Buckeye*, 126 S.Ct. at 1210).

B. ARBITRATOR DISCLOSURES

Last year, we reported on a questionable decision of the Fifth Circuit in *Positive Software Solutions v. New Century Mortgage Corp.*,⁵ setting aside an award because an arbitrator did not disclose that he and his former law firm had served as co-counsel with a law firm for New Century in "significant and protracted litigation" approximately seven years prior to the arbitration. The previous litigation was a patent dispute between Intel and Cyrix. The arbitrator and an attorney with the firm that represented New Century in the arbitration, were two of the 34 lawyers representing Intel in the previous litigation.

In a rare *en banc* reversal, the Fifth Circuit refused to set aside the award on an arbitrator's failure to disclose grounds.⁶ The court, after discussing the applicable law,⁷ stated:

No case we have discovered in research or briefs has come close to vacating an arbitration award for nondisclosure of such a slender connection between the arbitrator and a party's counsel. In fact, courts have refused vacatur where the undisclosed connections are much stronger.⁸

The *en banc* panel concluded with common sense language on arbitrator disclosures:

Finally, requiring vacatur on these attenuated facts would rob arbitration of one of its most attractive features apart from speed and finality—expertise. Arbitration would lose the benefit of specialized knowledge, because the best lawyers and professionals, who normally have the longest lists of potential connections to disclose, have no need to risk blemishes on their reputations from post-arbitration lawsuits attacking them as biased.

Neither the FAA nor the Supreme Court, nor predominant case law, nor sound policy countenances vacatur of FAA arbitral awards for nondisclosure by an arbitrator unless it creates a concrete, not speculative impression of bias. Arbitration may have flaws, but this is not one of them. The draconian remedy of vacatur is only warranted upon nondisclosure that involves a significant compromising relationship. This case does not come close to meeting this standard.⁹

C. SCOPE OF REVIEW

⁵ 436 F.3d 495 (5th Cir. 2006).

⁶ *Positive Software Solutions v. New Century Mortgage Corp.*, No. 04-11432, 2007 WL 111343 (5th Cir. Jan. 18, 2007).

⁷ including *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 US 145, 89 S.Ct. 337 (1968).

⁸ *Positive Software Solutions*, 2007 WL 11343, *6.

⁹ *Id.* at *8. For other recent examples of court's refusal to set aside awards on failure to disclose grounds see: *Kimm v. Alaska Sales & Service*, --P3d--, 2006 WL 2789375 (AK 2006); *Uhl v. Komatsu Forklift Co.*, No. 04-10148, 2006 WL 3751388 (E.D. Mich. Dec. 8, 2006); and *RDC Golf of Florida, Inc. v. George P. Apostolicas*, -- So. 2d --, 2006 WL 664207 (Fla. 5th DCA 2006).

Contrary to most circuits, the Fifth Circuit Court of Appeals has upheld contractual clauses providing for expanded judicial review of arbitration awards.¹⁰ In *Nat'l Resort Mgt. Corp. v. Cortez*,¹¹ a Northern District of Texas decision, the court recently set aside an award in a sexual harassment case based on contract language providing: "In an action seeking to vacate an award, the standard of review applied to the Arbitrator's findings of fact and conclusions of law will be the same as that applied by an appellate court reviewing a decision of a trial court without a jury."¹²

Other circuits have held that expanded scope of review clauses are unenforceable because parties cannot create additional grounds of vacatur or delineate the scope of review beyond the Federal Arbitration Act ("FAA").¹³ For example see *Bowen v. Amoco Pipeline Co.*,¹⁴ holding that "parties may not interfere with the judicial process by dictating how the federal courts operate."

D. NON SIGNATORIES BOUND TO ARBITRATE

Last year two Texas Supreme Court cases required a non-signatory to a contract to arbitrate disputes on grounds of equitable estoppel. In *re Vesta Group, Inc.*,¹⁵ the Supreme Court held that a party to an arbitration agreement must arbitrate tortious interference claims against the other signatory's agents or affiliated parties.

In *Alton J. Meyer, et. al. v. WMCO-GP, LLC*,¹⁶ the Texas Supreme Court held that a suit by a party to a purchase agreement for a Ford dealership against Ford and its selected assignee Meyer had exercised a right of refusal to stop the sale, and were subject to arbitration on the motion of Ford and Meyer. The purchase agreement contained an arbitration clause to which neither Ford nor Meyer were parties. The court of appeals had, in the opinion of the Texas Supreme Court, correctly stated the law but misapplied it. The court of appeals had denied the motion to compel arbitration because the suit did not require a construction of the purchase agreement ("PSA"), and was against non-parties. The arbitration agreement on its face was limited to "[a]ny controversy between the parties to this agreement . . ." The Texas Supreme Court construed the language more broadly stating:

Equitable estoppel cannot give non-parties a greater right to arbitration than the parties themselves have. But the text of the arbitration provision here is not so restrictive. The phrase 'between the parties,' without more, suggests only that Bullock and WMCO meant to ensure that the agreement applied to disputes between them, not that they intended to preclude the application of equitable estoppel . . . The court of appeals gave a second reason for not applying equitable

¹⁰ See *Hughes Training, Inc. v. Cook*, 254 F.3d 588 (5th Cir. 2001) (holding that standard of review set forth in arbitration agreement applied to district court's review of arbitration award).

¹¹ No. 4:06-CV-641-A, 2007 WL 142589 (N.D. Tex. Jan. 16, 2007).

¹² *Id.* at *1.

¹³ 9 U.S.C. § 1, *et seq.*

¹⁴ 254 F. 3d 925, 936 n.8 (10th Cir. 2001).

¹⁵ 192 S.W. 3d 759 (Tex. 2006).

¹⁶ No. 04-0252, 2006 WL 3751585 (Tex. Dec. 22, 2006).

estoppel: WMCO's claims against Meyer and Ford did not rely on the terms of the PSA but merely 'touch[ed] upon' or 'related to' it. But this does not defeat the application of equitable estoppel. WMCO's other claims against Meyer and Ford also all depend on the existence of the PSA.¹⁷

Another example of this trend is *Cappadonna Electrical Management, et. al. v. Cameron County*,¹⁸ holding that a county was required to arbitrate claims against subcontractors because its prime contract had an arbitration clause in the general conditions. The court relied on the Supreme Court's decisions in *In re Kellogg, Brown & Root*¹⁹ and *In re Weekley Homes*.²⁰

E. MANIFEST DISREGARD OF LAW

The "manifest disregard of law" standard for vacating an arbitration award remains questionable. The doctrine arose out of dicta in the United States Supreme Court's holding in *Wilko v. Swan*.²¹

Although attempted frequently, the doctrine has rarely been the basis for judicial rejection of an award. Its viability—or even existence—is questionable. The Fifth Circuit Court of Appeals discussed the standard in *Prestige Ford v. Ford Dealer Computer Services, Inc.*,²² concluding that the "manifest disregard of law standard is an extremely narrow, judicially-created rule with limited applicability."

The Supreme Court has again passed on an opportunity to rule on the applicability of the standard by denying a petition for certiorari in *Patten v. Signator Insurance Agency*.²³

F. COMPELLING ARBITRATION

*In re Jim Walter Homes, Inc.*²⁴ presents an interesting case illustrating the breadth of an arbitration clause. The company and homeowners signed a contract containing a broad arbitration clause of all claims, ". . . whether asserted in tort, contract or warranty . . . and whether arising before, during or after performance of this Agreement."²⁵ When the plaintiffs sued Jim Walter Homes for defective construction and various claims, including personal

¹⁷ *Id.* at *3.

¹⁸ 180 S.W.3d 364 (Tex. App.—Corpus Christi 2005, no pet. h.).

¹⁹ 166 S.W.3d 732 (Tex. 2005) (holding a second-tier subcontractor was not required to arbitrate its quantum meruit claim against the contractor under a direct benefits estoppel theory).

²⁰ 180 S.W.3d 127 (Tex. 2004) (holding, as a matter of first impression, that arbitration clause was binding on child, even though she was not a party to the contract).

²¹ 346 US 427, 436-437(1953) (holding that the right to select judicial forum is the kind of 'provision' which cannot validly be waived, and that an agreement to arbitrate future controversies between securities brokers and buyer is invalidated by the Securities Act's express provision against waiver), *overruled by Rodriguez de Quijas v. Shearson/American Exp., Inc.*, 490 U.S. 477, 109 S.Ct. 1917 (1989) (holding that a pre-dispute agreement to arbitrate claims under the Securities Act was enforceable).

²² 324 F.3d 391, 395-396 (5th Cir. 2003), *cert. denied*, 540 US 878 (2003).

²³ 441 F.3d 230 (4th Cir. 2006), *cert. denied*, 127 S.Ct. 434 (2006) (holding that arbitrator acted in manifest disregard of the law by implying one-year limitations period into parties' employment agreement).

²⁴ 207 S.W.3d 888 (Tex. App.—Houston [14th Dist.] 2006, no pet. h.).

²⁵ *Id.* at 893.

injuries [falling through a section of flooring removed during repair efforts and injuries from a cabinet door falling off its hinges], Jim Walter moved to compel arbitration. The trial court ordered arbitration of all claims except for the personal injury claims. Both parties sought review by mandamus; the homeowner of the order compelling arbitration and Jim Walter of the order denying arbitration of the personal injury claims.

The appellate court held that pursuant to the FAA orders denying arbitration are reviewable by mandamus, but orders granting a motion to compel are not. The court quoted from the Texas Supreme Court's recent holding in *In re Palacios*:²⁶

We recognize there is some one-sidedness in reviewing only orders that deny arbitration, but not orders that compel it. Yet in both the Federal and Texas acts leave little uncertainty that this is precisely what the respective legislatures intended.²⁷

After discussing the current law on compelling arbitration, the court of appeals held that the personal injury claims were arbitrable, stating,

Courts recognize the use of 'any dispute arising out of or relating to' as broad language that expressly includes tort and other claims relating to the contractual relationship.²⁸

The court also held that the Texas Arbitration Act ("TAA")²⁹ was inapplicable to the dispute because the parties agreed to be bound by the FAA. Additionally, it held that an evidentiary hearing was not required to compel arbitration. Supporting the motion by affidavit and attaching an authenticated copy of the agreement containing the arbitration clause and setting forth the interstate commerce facts in the affidavit, was all that was required.

Author's Note: Although this case establishes no new precedent, it provides a good primer on current law on compelling arbitration. We are indebted to Jim Walter Homes for its continued supply of construction law cases.

G. ARBITRATION COMPELLED EVEN THOUGH DEBTOR WAS IN BANKRUPTCY

The Eleventh Circuit recently held that a debtor subcontractor's action against a general for a share of the general's settlement with an owner was not a core proceeding; therefore, it was subject to arbitration. *See Whiting Turner Contracting Co. v. Electric Machinery Enterprises, Inc.*, No. 06-13733, 2007 WL 548781 (11th Cir. Feb. 23, 2007).

²⁶ No. 05-0038, 2006 WL 1791683 (Tex. June 30, 2006) (holding that a trial court order compelling arbitration was not reversible by mandamus).

²⁷ *In re Jim Walter Homes, Inc.*, 207 S.W.3d at 895.

²⁸ *Id.* at 895.

²⁹ Tex. Civ. Prac. & Rem. Code §§ 171.021-171.026 and 171.096(d).

H. ARBITRATOR IMMUNITY

Arbitrators may have their awards set aside, but they are not liable for their errors. The Texarkana Court of Appeals upheld the doctrine of arbitral immunity in the case of *Pullara v. American Arbitration Association, Inc.*³⁰ In *Pullara*, Michael Pullara arbitrated a dispute against Becker Fine Builders, Inc. over the remodeling of his apartment. The arbitrator ruled in favor of the builder. Approximately one year after the arbitration, Pullara learned that the arbitrator had acted as general counsel for the Greater Houston Builder Association (“GHBA”) and had failed to disclose his role in the GHBA prior to the arbitration. Since the ninety day deadline to vacate the award had passed, Pullara sued the American Arbitration Association (“AAA”) and the arbitrator. The AAA and the arbitrator claimed arbitral immunity and moved the trial court to grant summary judgment against Pullara on that basis. The trial court agreed with the AAA and the summary judgment was granted. The Texarkana Court of Appeals affirmed the trial court’s decision and held that arbitrators are immune from civil liability for failing in their duty to disclose a source of possible bias or partiality. In reaching this decision, the court of appeals cited and agreed with the Austin Court of Appeals decision in *Blue Cross Blue Shield of Texas v. Juneau*,³¹ where the court also held that arbitral immunity applied in Texas. The *Pullara* Court also acknowledged that virtually all of the various states and federal courts also recognized arbitral immunity.

I. ARBITRATION SUBPOENAS

In *Dynergy Mainstream Services v. Trammochem, et. al.*,³² the Second Circuit denied enforcement of arbitration subpoenas on non-parties outside the geographical limits of the district where the arbitrators were conducting a hearing. The court held that Section 7 of the FAA does not authorize nationwide service.

J. WAIVER OF RIGHT TO ARBITRATE

In *Perry Homes v. Cull*,³³ the issue before the Texas Supreme Court is whether a plaintiff-homeowner waives the right to arbitration when the plaintiff-homeowner (a) files a lawsuit against the builder and warranty companies; (b) files a motion opposing arbitration with the AAA; (c) conducts extensive discovery lasting nearly one year; and (d) files a motion to compel arbitration on the eve of trial.

In 1996, the Culls purchased a home from Perry Homes, which had designed and constructed the home. At closing, the Culls purchased a home warranty from Home Multiple Equity, Inc. and Warranty Underwriters Insurance Company. After years of fighting with Perry Homes and the warranty companies over repairs required to fix foundation and drainage problems, the Culls filed suit against the three companies. The warranty companies filed a

³⁰ 191 S.W.3d 903 (Tex. App.—Texarkana 2006, pet. denied).

³¹ 114 S.W.3d 126 (Tex. App.—Austin 2003, no pet.).

³² 451 F.3d 89 (2nd Cir. 2006).

³³ 173 S.W.3d 565 (Tex. App.—Fort Worth 2005, pet. granted).

motion to compel arbitration, citing the arbitration clause in the warranty documents. The Culls opposed the use of the AAA, claiming the AAA was incompetent, biased, and charged excessive fees and was therefore “unconscionable.” The trial court never ruled on the warranty companies’ motion to compel.

Nearly a year passed, during which time the Culls amended their petition to add several new claims, pursued what Perry Homes’ called “extensive discovery on the merits” including 20 separate written requests for discovery, 11 depositions, and filed five motions to compel. The trial was set for December 10, 2001. Shortly before trial, the Culls filed a motion to compel arbitration, and only Perry Homes filed a response opposing the motion. (Although neither of the warranty companies filed a response, Perry Homes put in a footnote in its response claiming that the warranty companies joined in it). The trial court granted the Culls’ motion.

Perry Homes then filed an original proceeding in the Court of Appeals claiming the homeowners had waived their right to arbitration. The court of appeals denied Perry Homes’ Writ of Mandamus. Shortly thereafter, Perry Homes filed an original proceeding with the Texas Supreme Court on the same grounds. The Supreme Court likewise denied the Petition for Mandamus.

The parties arbitrated the dispute, and the arbitrator awarded the homeowner over \$800,000 in damages, and rescinded the purchase of the home. The trial court confirmed the arbitration award, and Perry Homes appealed the confirmation, once again claiming that the homeowners had waived their right to arbitration. The Fort Worth Court of Appeals modified the trial court’s order with regard to post-judgment interest, but affirmed that the Culls had not waived their right to arbitration. The Supreme Court has granted Perry Homes’ Petition for Review.

In Texas, a party waives arbitration by “substantially invoking the judicial process.”³⁴ Perry Homes argues that there is a split amongst the Court of Appeals. In some courts, the test is whether the plaintiff has asked the court to make any judicial decision on the merits of the case, while in others, “affirmative acts . . . to further invoke the judicial process” is sufficient to waive the right to arbitration.³⁵ According to Perry Homes, if waiver by a plaintiff only occurs if the plaintiff has asked the trial court for a ruling on the merits, the bar for waiver is set too high and is a recipe for abuse and delay.

On the other hand, the Culls argue that (1) neither warranty company filed a motion opposing arbitration, (2) that the law of the case doctrine prevents Perry Homes from getting a second bite at the apple, [Because Perry Homes filed writs of mandamus in both the Court of Appeals, and with the Texas Supreme Court seeking to overturn the order to compel arbitration, the law of the case doctrine now prevents Perry Homes from raising the waiver issue] and (3)

³⁴ *EZ Pawn Corp. v. Mancias*, 934 S.W.2d 87, 89 (Tex. 1996) (holding that once employer had established valid agreement under the FAA, employee had the burden to defeat it, and must overcome strong presumption favoring arbitration).

³⁵ *Central Nat’l Insurance Co. v. Lerner*, 856 S.W.2d 492, 494-95 (Tex. App.—Houston [1st Dist.] 1993, no pet.) (orig. proceeding) (holding that insurer waived right to contractual arbitration by invoking judicial process to detriment of insureds).

that Perry Homes failed to show how it was prejudiced by the order compelling arbitration because the arbitrator could have permitted the same amount of discovery as in litigation.

K. SOLE CHOICE CLAUSE UPHELD

The Sixth Circuit upheld the validity of a one-sided choice clause giving one party the right to select arbitration or litigation in *Wigley v. N/S/ Corp.*, 445 F3d 861 (6th Circuit 2006).

L. AIA MAKES LITIGATION DEFAULT

The American Institute of Architects 2007 edition of A-101 and A-201 will make litigation the default method of dispute resolution if the parties fail to check arbitration in the new contract forms. The '07 edition will provide a menu of ADR or litigation choices.

In spite of substantial requests from several industry sources, the AIA has held firm, and the new documents (to be released in October 2007) will provide for litigation unless the contracting parties affirmatively select arbitration. Mediation will remain with the AAA being the designated provider.

M. ESTOPPEL TO DENY INTERSTATE COMMERCE

It is difficult to imagine a construction project that is not involved in interstate commerce and subject to the *Federal Arbitration Act*. A recent case held that a party was estopped from arguing that tort and contract disputes did not involve interstate commerce because the contract provided that "[t]his agreement is made pursuant to a transaction in interstate commerce and shall be governed by the *Federal Arbitration Act* at 9 U.S.C. 1."

The plaintiff also argued that its tort claims, involving the repossession of a mobile home, were unrelated to the agreement. The court rejected this argument because a broad arbitration clause included "all disputes . . . including, but not limited to contract, tort and property disputes . . ." See *Bishop v. Green Tree Servicing, LLC*, (W.D.N.C. 2007), 2007 WL 959524.

Author's Note: A drafting tip is to simply state that the parties agree the project and their contract involve interstate commerce. Also the mentioning of the *FAA* in the arbitration clause will insure it is applied procedurally as opposed to state arbitration laws.

II. INSURANCE

A. DEFECTIVE WORK COVERED?

The industry and its attorneys in Texas await the Supreme Court's decision on coverage for defective work in *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*³⁶ The Tennessee Supreme

³⁶ 335 F.Supp.2d 754 (W.D.Tex. 2004); *certified question to Texas Supreme Court* 428 F. 3d 193, 200-201 (5th Cir. 2005) (Oral arguments were heard in February 2006.)

Court has found defective construction by a subcontractor is an occurrence under a CGL Policy in *Travelers Indemnity Co. v. Moore & Associates, Inc.*³⁷

B. CERTIFICATES OF INSURANCE - WORTHLESS

Via Net v. TIG Insurance Company, et al.,³⁸ is a significant decision reflecting the questionable value of certificates of insurance, and the Supreme Court's attitude toward the discovery rule.

In *Via Net*, Safety Light advised its vendors that it would no longer do business with them unless they added it as an additional insured under their commercial general liability policies. Via Net agreed to do so and its broker issued a certificate of insurance, which stated that

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW.

About nine months after the certificate was issued, a Via Net employee was injured due to the alleged negligence of Safety Light. After a suit by the injured employee, Safety Light made demand on Via Net's carrier, Lumbermen's Mutual, for a defense. Lumbermen's denied coverage because Safety Light had not been named an additional insured under Via Net's policy. Four years later, Safety Light's own carrier, TIG Insurance Company, sued Via Net for failing to add Safety Light as an additional insured. Via Net's defense was limitations because the suit, although filed less than four years after coverage was denied, was more than four years after Via Net breached its contract by failing to provide the additional insured coverage. Safety Light attempted to rely on a discovery rule to avoid the four-year statute of limitations, but summary judgment was entered against it. The court of appeals reversed the trial court, holding that the discovery rule deferred limitations until Safety Light learned of the denial of coverage.

After discussing the very limited situations justifying application of the discovery rule to situations where "the nature of the injury incurred is inherently undiscoverable and the evidence of injury is objectively verifiable,"³⁹ the Supreme Court held the failure to purchase insurance was not "inherently undiscoverable," because Safety Light, if it had obtained the underlying policies, rather than relying upon the certificates of insurance, could have discovered that there was no insurance in place. The Court, noting Safety Light's argument that certificates of insurance would be useless if a party could not rely on them, stated:

Safety Light argues that it acted diligently by obtaining a certificate of insurance listing it as an additional insured. But the certificate warned that it conferred no rights and was limited by the underlying policy. Safety Light argues, with some force, that there is little use for certificates of insurance if contracting parties must verify them by reviewing the full policy. But the purpose of such certificates is

³⁷ 2006 WL 4099997 (Tenn. March 7, 2007). Counsel for Lamar Homes brought the case to the attention of the Supreme Court.

³⁸ No. 05-0785, 2006 WL 3759389, 50 Tex S.Ct. J. 296 (Tex. Dec. 22, 2006).

³⁹ quoting from *Computer Assoc. Int'l v. Altai, Inc.*, 918 S.W.2d 453, 456 (Tex. 1996).

more general, "acknowledging that an insurance policy has been written, and setting forth in general terms what the policy covers." *BLACK'S LAW DICTIONARY* 240 (8th ed. 2004). Given the numerous limitations and exclusions that often encumber such policies; **those who take such certificates at face value do so at their own risk.**⁴⁰ (emphasis added)

Author's Note: The Court used strong language to suggest that it has restricted discovery rule to "exceptional cases to avoid defeating the purposes behind the limitations statutes," noting that "contracting parties are generally not fiduciaries" and therefore "due diligence requires that each protect its own interests."⁴¹

III. GOVERNMENT CONTRACTS

A. FALSE CLAIMS

Various statutory provisions prohibit and punish false claims in federal contracting. One of those statutes is the fraud provision of the Contract Disputes Act, which provides:

If a contractor is unable to support any part of his claim and it is determined that such inability is attributable to misrepresentation of fact or fraud on the part of the contractor, he shall be liable to the Government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of claim."⁴²

The dangers of an overstated claim that is not established, and the dire consequences that can result, are illustrated in the U.S. Court of Federal Claims decision in *Daewoo Engineering and Construction Co., Ltd. v. U.S.*⁴³ While performing an extremely difficult road project on a tropical island in the Pacific, Daewoo attempted to get the Corps of Engineers to accept a compaction alternative to the specified standard. Daewoo also blamed moisture and defective weather information for its extra costs to achieve the specified compaction. The Corps refused to accept Daewoo's alternative; therefore, it filed a claim for \$13.4 million in "incurred damages" as of December 31, 2001 and projected additional costs for performance beyond that date of \$50 million. The claim was certified by Daewoo's Project Manager, Mr. J.W. Kim, that it was "made in good faith," as required by the statute, which specifies that "the supporting data must be accurate and complete to the best of [the corporate official's] knowledge and belief, [and] the amount requested [must] accurately reflect the contract adjustment for which the contractor believes the government is liable . . ."⁴⁴ Mr. Kim testified that part of the claim was to get the Government to "pay attention" so it would agree to Daewoo's compaction method. The opinion describes and condemns the projected \$50 million damages as a "negotiating ploy."⁴⁵ The court held that Daewoo proved no viable cause of action, cited various acts of bad faith, and finally

⁴⁰ *Via Net*, 2006 WL 3759389, *3.

⁴¹ *Id.* at *2

⁴² 41 USC § 604.

⁴³ 73 Fed. Cl. 547 (2006).

⁴⁴ 41 USC § 605(c)(1).

⁴⁵ *Daewoo*, 73 Fed. Cl. at 585.

granted a government counterclaim for fraud and awarded \$50 million to the government plus costs and attorney's fees for the certification of the \$50 million in future damages.

Among many of the condemnations of Daewoo in his 50-page opinion, the trial judge concluded:

We suspect that Daewoo's entire claim is fraudulent. However, plaintiff's apparent incompetence in putting together its claim, along with the unwillingness of its witnesses to explain the process, provides it an ironic benefit. That is, we found it difficult to locate the line between fraud and mere failure of proof in this case.

It is theoretically possible that plaintiff's \$13 million claim represents an amount that it could have incurred because of defective specification, had such a theory been applicable, but plaintiff could not prove it because it employed the wrong legal theories and its witnesses were not credible. For these reasons, we limited findings of fraud to the \$50 million claim that clearly is fraudulent.

Witnesses including Mr. Kim testified that the extra \$50 million claim was a means to get the Government's attention, and to show the Government what would happen if it did not approve the new compaction method that plaintiff wanted. Daewoo did not file that part of the claim in good faith; it was not an amount to which plaintiff honestly believed it was entitled. Whether Daewoo wanted the money or wanted the Government's attention, \$64 million was not an amount the Government owed plaintiff at the time of certification, and plaintiff knew it."⁴⁶

Author's note: This 50-page decision by Judge Robert W. Hodges, Jr. will be appealed. Regardless of what ultimately happens, the opinion should be studied by construction attorneys and government contractors. It presents a horror story of what can happen by asking for amounts that cannot be supported. Certifying claims on federal projects should be done with extreme care and satisfaction that the amount certified is supportable. **DO NOT HORSE TRADE WITH CERTIFIED CLAIMS!**

Another recent example of the harsh application of the *False Claims Act* is the case of *Morse Diesel Int'l, Inc. v. U.S.*, 2007 WL 25918 (Fed. CL. Jan. 26, 2007), wherein the contractor's submission of a claim for reimbursement of bond premiums (when the costs had not yet been incurred), was held to be a violation. Morse Diesel submitted payment applications including bond premiums which had not been paid.⁴⁷ Also, Morse charged a fee of its parent company for its indemnity of the surety as bond premiums. Relying on a provision of the *False Claims Act*, 31 U.S.C. § 3729(a)(1), the U.S. Court of Federal Claims granted the government's motion for summary judgment and held that the contractor forfeited its claims for damages in the sum of \$53.5 million dollars.

⁴⁶ *Id.* at 595-96.

⁴⁷ 48 CFR § 52.232-5(g), "Payments Under Fixed Price Contracts" requires that reimbursement for performance and payment bonds is conditioned on "The Contractor . . . furnish[ing] evidence of full payment to the surety".

Author's Note: Contractors routinely apply for payment of bond premiums prior to paying them on private projects. This case, other than the disguising of the fee to the parent company for indemnifying the surety, is another example of the extreme care and knowledge of federal procurement statutes and rules required when working for the government.

B. NO RELIEF FROM STEEL PRICE INCREASES UNDER A FIXED PRICE CONTRACT

In *Appeal of Spindler Construction Corp.*,⁴⁸ a contractor's attempt to recover for a claim based on unexpected steel price increase was rejected by the Armed Services Board of Contract Appeals. The contractor contended that steel price increase of 23% provided grounds for relief under the doctrine of "commercial impracticality." The Board described the doctrine as a subset of the doctrine of "legal impossibility" and agreed that the Restatement (Second) of Contracts § 261 had "reformulated" the doctrine of impossibility. The Board, relying on the case of *Seaboard Lumber Co. v. United States*,⁴⁹ stated that to recover on grounds of commercial impracticality a contractor must show (1) a supervening event made performance impracticable; (2) the nonoccurrence of the event was a basic assumption upon which the contract was based; (3) the occurrence of the event was not the contractor's fault; and (4) the contractor did not assume the risk of the occurrence. The government successfully proved that the increase as a percent of the total contract was small and that a fixed price contract places the risk of price increases on the contractor.

Authors' Note: This decision is predictable in view of the absence of a price adjustment clause for material cost changes. Would a supplier fare better under Section 2-615 of the UCC in a non-government contract? The contractor also relied on provisions of 2-615 of the Uniform Commercial Code, but the contracting officer rejected the application of common law or state law. Section 2-615 was not discussed by the Board. A supplier would probably not be able to sustain the burden to prove commercial impracticability on a fixed price contract. For an analysis of the problems of and possible relief from escalating steel prices, see R.A. Guidry, The Steel Price Explosion: What is an Owner or a Contractor to Do? 24 Construction Lawyer 5 (ABA Forum Committee on the Construction Industry –2004).

C. CIVILIAN BOARD OF CONTRACT APPEALS

The National Defense Authorization Act for Fiscal Year 2006 consolidated eight (8) existing, non-defense Boards of Contract Appeals into a single Civilian Board of Contract Appeals, with jurisdiction over contract disputes from non-defense agencies. Exceptions are the Board of Appeals for the postal service and the T.V.A.

⁴⁸ A.S.B.C.A. No. 55007 (July 31, 2006), 2006 WL 2349234 (A.S.B.C.A. 2006).

⁴⁹ 308 F.3d 1283 (Fed. Cir. 2002) (holding that performance only excused when objectivity impossible and that slump in lumber market did not create objective impossibility of performance).

IV. CONSTRUCTION LITIGATION

A. HOMEOWNER CLAIMS

There were no decisions of any significance in the homeowner arena, last year. Three reported cases were fact-specific, and applied to existing law:

1. The RCLA does not preempt the DTPA.⁵⁰
2. Cases decided under the DTPA can include damages for mental anguish.⁵¹

In *Hernandez v. Lautensack*,⁵² the court addressed the effect of a deficient pre-suit RCLA notice, and of an excessive demand, and found that neither was fatal to the homeowner's claims. The homeowner hired a roofer to replace a slate tile roof on his house. The roof leaked and the homeowner had the roofer come out on several occasions to try to fix it. The homeowner gave up on the roofer [who claimed that the leaks were due to hail damage] and hired another roofer to install a new roof. The owner sent the roofer a demand letter for \$41,000 and filed suit against him, three months later. The jury found for the homeowner for about \$25,000, but also found that the homeowner's notice was untimely. The district court disregarded the latter answer and entered judgment for the homeowner.

On appeal, the Fort Worth court said that the intent of the notice requirement in RCLA was to give the contractor a reasonable opportunity to inspect the property, and that it had been "effectuated under the facts of this case... Hernandez [the roofer] did in fact inspect the roof many times when he attempted to repair leaks before it was replaced and submitted a bid to replace the roof in September 2002...The fact that Lautensack [the homeowner] had the defective roof replaced before he sent his notice letter did not deprive [the roofer] of the opportunity to inspect the roof, make an offer to repair or replace the roof, or to make a timely, monetary settlement offer."⁵³

The roofer also complained about the district court's award of attorney's fees to the homeowner, contending that the pre-suit \$42,000 demand exceeded the amount ultimately found by the jury, and that attorneys' fees should therefore not have been awarded under RCLA. The court held, however, that

A demand is not excessive simply because it is greater than what the jury later determines is actually due... The dispositive inquiry for determining whether a demand is excessive is whether the claimant acted unreasonably or in bad faith... Application of this rule is limited to situations where the creditor refuses a tender

⁵⁰ *Gentry v. Squires Constr., Inc.*, 188 S.W.3d 396, 406 (Tex. App.—Dallas 2006, no pet. h.) (holding that the RCLA did not preempt homeowner's claims for breach of contract, breach of warranty, fraud, or DTPA).

⁵¹ *Main Place Custom Homes, Inc. v. Honaker*, 192 S.W.3d 604 (Tex. App.—Fort Worth 2006, pet. denied). (Plaintiff suffered migraine headaches, plaintiff's relationship with husband suffered, husband was depressed, and thus, he and his wife fought more often and weren't able to relax and enjoy their home as they had hoped to do so.).

⁵² 201 S.W.3d 771 (Tex. App.—Fort Worth 2006, pet. filed).

⁵³ *Id.* at 776.

of the amount actually due or indicates clearly to the debtor that such tender would be refused.

Since there was no evidence that the roofer had ever tendered any amount, it was immaterial that the jury verdict happened to be less than the amount that actually had been demanded.⁵⁴

The significance of the decision, if any, appears to be the court's willingness to disregard the very precise notice requirements of the statute [and the jury's verdict] and to substitute instead a fact-based standard in which the contractor's "reasonable opportunity to inspect the property" was "effectuated under the facts of the case."

B. WARRANTIES

In *Hirschfeld Steel Co. v. Kellogg Brown & Root, Inc.*,⁵⁵ a subcontractor sued a general contractor and public owner for the balance due under a subcontract and seeking a declaration that its ten-year warranty on a roofing system had been voided by the owner's failure to perform maintenance. After examining the terms of the warranty, the court found that the ten-year warranty by the subcontractor was not conditioned upon proper maintenance by the Owner and, if maintenance had been a condition, the warranty should have contained language such as "on the express condition precedent" or similar language. Under the definition of substantial completion submitted to the jury, the court found that the subcontractor's wrongful repudiation of its warranty (based on its contention that improper maintenance had been performed) could have resulted in a finding of no substantial performance and the subcontractor was denied its contract balance claim.

The subcontract did require that Hirschfeld prepare a ten-year maintenance program and clearly indicated that the owner would employ a maintenance contractor to inspect and maintain the roof system, but performance of those obligations was not worded as a condition precedent to the warranty. The court's opinion provides some good drafting guidance and a summary of the law on whether or not contract language creates a condition or covenant:

To determine whether a condition precedent exists, the intention of the parties must be ascertained, and that can be done only by looking at the entire contract. To make performance specifically conditional, a term such as 'if,' 'provided that,' 'on condition that,' or some similar phrase of conditional language normally must be included. If no such language is used the terms typically will be construed as a covenant in order to prevent a forfeiture. Though there is no requirement that such phrases be utilized, their absence is probative of the parties' intention that a promise be made, rather than a condition imposed. In construing a contract, forfeiture by finding a condition precedent is to be avoided when another reasonable reading of the contract is possible. When the intent of the parties is doubtful or when a condition would impose an absurd or impossible result, the

⁵⁴ *Id.* at 777-78.

⁵⁵ 201 S.W.3d 272 (Tex. App.—Houston [14th Dist.] 2006, no pet. h.).

agreement will be interpreted as creating a covenant rather than a condition. Because of their harshness in operation, conditions are not favored in the law.

There is no language in the Subcontract stating that there will be a ten-year warranty from Hirschfeld 'if,' 'provided that,' or 'on condition that' the written maintenance program is followed. There is no contract language stating that nonperformance of the maintenance program will void the warranty."⁵⁶

A potentially significant decision involving a purported implied warranty of development services is *Welwood v. Cypress Creek Estates, Inc.*⁵⁷

There, plaintiff, a homebuilding company, purchased a lot from a developer. In the contract of sale, the developer agreed "...to develop the lots in a good and workmanlike manner in accordance with the standards of the City of Frisco," but disclaimed any express or implied warranties. The purchaser agreed to rely on his own inspection of the lots and agreed to accept the lots "in their 'as is' condition."

The purchaser built a custom home on the lot and put up a retaining wall, landscaping and pool decking, all of which promptly slid into the lake behind his lot when the slope failed because of its lack of shear strength. The purchaser claimed that the slope's stability would have been identified if the developer followed his own engineer's recommendations to conduct a slope stability analysis, and that his failure to do so was a breach of his implied warranty of "good and workmanlike development services," which also triggered a DTPA violation.

He filed suit, but the developer obtained a summary judgment, from which the purchaser appealed.

The Dallas court questioned whether there was indeed an implied warranty of development services and suggested—without holding—that the 15 year-old decision in *Lucker v. Arnold*,⁵⁸ which had implied such a warranty, probably was not good law, in light of the Supreme Court's subsequent decision in *Parkway Co. v. Woodruff*.⁵⁹

The court said that even if such a warranty existed, it could indeed be disclaimed in a homeowner transaction, analogizing the alleged implied warranty for development services to the implied warranty of good and workmanlike construction which the Supreme Court allowed to be disclaimed in *Centex v. Buecher*.⁶⁰ The summary judgment was therefore affirmed. The

⁵⁶ *Id.* at 281 (footnotes & internal citations omitted).

⁵⁷ 205 S.W.3d 722 (Tex. App.—Dallas 2006, no pet h.).

⁵⁸ 843 S.W.2d 108 (Tex. App.—Fort Worth 1992, no writ) (holding that jury could appropriately find that developer failed to develop subdivision in a good and workmanlike manner).

⁵⁹ 901 S.W.2d 434 (Tex. 1995) (holding that there is no implied warranty that developer's post sale development services would be performed in a good and workmanlike manner).

⁶⁰ 95 S.W.3d 266 (Tex. 2002) (holding that implied warranty of good workmanship could be disclaimed by parties if agreement provided for manner, performance, or quality of desired construction, though the implied warranty fo habitability cannot be disclaimed generally.) The Court apparently felt that a "gap filler" warranty might be harder to disclaim, but because the developer in this case had specifically warranted that it would follow the City of

case is consistent both with the Texas courts' (1) continuing skepticism of implied warranties, and (2) their willingness to allow them to be disclaimed with "as is" or similar language.

C. DIFFERING SITE CONDITIONS

Barnard Constr. Co., Inc. v. City of Lubbock.⁶¹, involved a contract for the construction of fifteen pipelines for the City of Lubbock. The City and its engineer thought that only one of the pipelines might involve rock excavation, and therefore the bid forms included a line item for rock work on only one of the fifteen pipelines. The general conditions, however, under Paragraph 17 "Contractor's Understanding" stated:

It is understood and agreed that the contractor has, by careful examination, satisfied itself as to the nature and location of the work, the confirmation of the ground, the character, quality and quantity of materials to be encountered, the character of the equipment and facilities needed preliminary to and during the prosecution of the work and the general and local conditions, and all other matters which in any way affect the work under the contract documents. . . . Unless specified herein, all loss, expense or damage to contractor arising out of the nature of the work to be done, or from the action of the elements, or from any unforeseen circumstance and the prosecution of the work, shall be sustained and borne by the contractor at its own cost and expense.⁶²

The information for bidders expressly stated that the engineer's data was for informational purposes only, and suggested that the bidders had the opportunity to drill their own test holes and to attend a question and answer session prior to bidding.

Work commenced, and the contractor encountered rock on several other lines, for which it billed the City at the same unit cost that it had used on Pipeline A1. The City initially paid for the work, then offset payment for the rock, then reversed itself and agreed to pay for the rock work, then reversed itself again and decided against paying for the rock. The contractor filed suit in federal court, which granted the City's Motion for Summary Judgment. The contractor appealed to the Fifth Circuit, which affirmed, holding that

Paragraph 17 of the general conditions clearly places the risk of unforeseen circumstances on [the contractor]. Barnard bore the risk in undertaking the project under the terms of the contract.⁶³

The court also placed reliance upon the "final" decision of the owner's representative to deny the claim, citing Paragraph 14 of the general conditions, which stated:

Frisco's development standards, and did, there was no reason to have implied a more general warranty, and no reason to prevent a disclaimer of it.

⁶¹ 457 F.3d 425 (5th Cir. 2006).

⁶² *Id.* at 428.

⁶³ *Id.* at 428 (internal citations omitted).

The owner's representative shall, in all cases, determine the amounts and quantities of the several kinds of work which are to be paid under the contract documents, and shall determine all questions in relation to said work and the construction thereof, and shall, in all cases, decide every question which may arise relative to the execution of this contract on the part of said contractor... The owner's representative made a final decision as to the amount and quantity of excavated rock for which Barnard was to be paid when it determined under the contract that it need not pay for rock excavated outside of Line A1.⁶⁴

The dissent pointed out that under the terms of the contract, this "final" decision apparently was made more than once, and asked

...which of the City's diametrically opposed, sequential decisions regarding rock excavation was the final and conclusive one, and was therefore irrevocably and irreversibly binding on both parties?⁶⁵

Judge Weiner went on to note that

The panel majority opinion demonstrates an unwillingness even to recognize the possibility that whether a particular decision by the City is 'final and conclusive' is not simply whatever the City unilaterally may say.⁶⁶

The Court's reliance on the City's representative's "final decision" may be dicta, but its reliance upon the clause in the general conditions which allocated the risk of differing site conditions to the contractor was not. In this regard, the Court—without mentioning it—was following *Interstate Contracting Corp. v. City of Dallas*.⁶⁷

D. EXPERT WITNESSES

1. Privilege as Grounds for Disqualification

In a case of first impression in Texas, the Corpus Christi Court of Appeals decided whether a contractor's expert witness for trial was disqualified from testifying against a project owner because the expert's colleague in a consulting group had previously consulted with a project owner.⁶⁸ The court declined to adopt the attorney-client conflict standards and chose a less stringent standard. The court adopted a test which a majority of other jurisdictions have adopted in determining if there is a conflict of interest by a consultant or expert witness based on a prior relationship with an adversary. Under the test, disqualification is warranted if: (1) the moving party possessed an objective reasonable basis to believe that a confidential relationship

⁶⁴ *Id.* at 427.

⁶⁵ *Id.* at 431 (dissent by Judge Weiner).

⁶⁶ *Id.* at 430.

⁶⁷ 407 F.3d 708 (5th Cir. 2005) (holding that contractor's claims were barred by the risk allocation clauses in the general conditions).

⁶⁸ See *Formosa Plastics Corp. v. Kajima International, Inc.*, No. 13-02-00385-CV, 2006 WL 3804507 (Tex.App.—Corpus Christi, Dec. 8, 2006, no. pet. h.).

existed between that party and the expert witness; and (2) confidential or privileged information was in fact provided to the expert by the moving party.⁶⁹ The court went on to point out that in this case the project owner had never met the testifying expert, had never corresponded with the expert, nor spoken to the expert regarding the litigation. Furthermore, there was no evidence that the expert's partner, who had spoken to the owner, had communicated any confidential information to the expert. Therefore, the court determined that the two-prong test for disqualification could not be met because the project owner could not have reasonably expected that a confidential relationship existed between itself and the testifying expert, and there was no evidence that the testifying expert received any confidential information.

Author's Note: Further developments will occur as consulting firms seek and perform work for many companies. An attorney should inquire on the nature and extent of a consultant's contacts with an adverse party prior to making a selection.

Also, we note that *Formosa Plastics* may soon replace *Jim Walter Homes* as the major generator of construction law opinions.

2. Insufficient Basis for Opinion

In *Wyndham Int'l., Inc. v. Ace*,⁷⁰ an expert's testimony on forecasted hotel losses in a business interruption insurance case was rejected. The expert witness, a CPA, relied on monthly forecasts of room revenues prepared by employees of various Wyndham hotels. (The case was an attempt to recover losses from the tragic events of the September 11, 2001 terrorist attacks.) The forecasts were found to be an unreliable foundation for computing losses because the employees did not follow any economic model, did not have a constant reference point, and were not based on sufficient history of revenue. There were other flaws in the forecasts and the CPA's methods, including forecasting losses from some hotels by "extrapolation" of projected losses for others. One of the most glaring defects was the expert's using of the forecasts made by hotel employees at 101 hotels, and "extrapolating" that data to 62 others for which no study or forecasts had been made.

The court referred to a decision of the Third Circuit in *Heller v. Shaw*,⁷¹ which held that extrapolations are only permissible if based on a "scientifically valid mathematical formula." Also, Wyndham's argument that the properties for which damages were extrapolated only composed 13% of its total damage claim for lost revenues, was rejected as the court noted that the damages were not offered in the alternative but only the total damage calculation for all of its hotels, and concluded, "extrapolated projections premised on unreliable and flawed forecasts merely compounds the unreliability . . ."

Author's Note: Although not a construction case, it illustrates the dangers of sponsoring opinion testimony that is not based on a reliable foundation. Schedule experts who opine on responsibility for construction delays and damages must carefully review, test and question the client information they receive, and make certain that their opinions are based on reliable data.

⁶⁹ *Id* at *5 (Citing *Koch Ref. Co. v. (Jennifer L.) Boudreaux MV*, 85 F.3d 1179, 1181 (5th Cir. 1997)).

⁷⁰ 186 S.W.3d 682 (Tex. App.—Dallas 2006, no. pet. h.).

⁷¹ 167 F.3d 146 (3rd Cir. 1999).

Although the "measured mile" damage calculation method is sometimes accepted, it includes an element of extrapolation. Damages based on "industry studies" are calculated by gross extrapolation. Continued caution must be exercised in sponsoring expert testimony, as courts and arbitrators examine the methodology used to support conclusions and opinions. For another recent case rejecting expert testimony for failure to establish a methodology supporting an opinion, see *Mack Truck Lines v. Tamez*.⁷²

E. SUBSTANTIAL PERFORMANCE

A somewhat confusing case dealing with the measure of damages for a contractor which has substantially performed, but whose work was nevertheless less than perfect, is *RAJ Partners, Ltd. v. Darco Constr. Corp.*⁷³

The general contractor substantially completed construction, but the owner refused to pay the balance of the construction price, alleging that the general contractor had failed to perform as required under the contract. After a bench trial, the district court entered judgment in favor of the contractor for the balance of its contract price, even though it found that the hotel's brick veneer was not installed in a good and workmanlike manner. The contractor put on no evidence as to the cost of repairing the brickwork, but the court of appeals nevertheless affirmed the judgment because the district court also found that the "defects in the brick construction were 'aesthetic' and not structural."⁷⁴ The court of appeals interpreted this to mean that "because the brickwork was not in need of remedy, [the contractor] did not have the burden to prove the remedial cost."⁷⁵

That finding normally would require the contractor to prove up the cost of the remedial work if it was to recover under a substantial performance theory, but the court of appeals instead construed the finding to mean that:

We read the finding that the defects in the brickwork were 'aesthetic' to indicate the brickwork, although not installed in a good and workmanlike manner, was not in need of remedy... Because the brickwork was not in need of remedy, [the contractor] did not have the burden to prove the remedial cost.⁷⁶

This would appear to be something of a stretch, since it left the owner having to pay in full for work which the district court found was defective, albeit only aesthetically so. The owner apparently put on no evidence of the cost of repair, relying instead upon the contractor's obligation to do so, which, as the opinion shows, was misplaced.

F. MISCELLANEOUS

⁷² No. 03-0526, 2006 WL 3040534 (Tex. Oct. 27, 2006).

⁷³ No. 07-04-0524-CV, 2006 WL 3542992 (Tex. App.—Amarillo Dec. 8, 2006, no pet. h.).

⁷⁴ *Id.* at *2.

⁷⁵ *Id.*

⁷⁶ *Id.*

1. Trust Fund

A developer's violation of the Texas Trust Fund Statute⁷⁷ established in a default judgment, was held to be non-dischargeable in bankruptcy by the Ninth Circuit in *In re Munton*.⁷⁸ The Bankruptcy Code § 523(a)(4)⁷⁹ denies discharge of debts due to "fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny." The Fifth Circuit had earlier held that a violation of the statute was dischargeable in *Coburn Co. of Beaumont v. Nicholas (In re Nicholas)*⁸⁰ if the plaintiff fails to disprove affirmative defenses available to a debtor in a default judgment. The Ninth Circuit rejected the *Nicholas* holding, and held that the Trust Fund Statute creates a fiduciary relationship which is not dischargeable under § 523(a)(4). The court rejected the requirement of disapproving a debtor's affirmative defenses because it found that a defendant who fails to answer waives affirmative defenses.

2. Civil Rights

An interesting case which illustrates the diversity and breadth of construction law is *Oscar Renda Contracting, Inc. v. City of Lubbock, Texas*.⁸¹

Oscar Renda submitted the low bid on the South Lubbock Drainage Improvements Project, but the City Council awarded the contract to a higher bidder, on the grounds that they had reservations concerning Renda's business practices, which Renda said was a disguised reference to the City's previously-expressed concern that Renda was "lawsuit happy;" more specifically, the fact that Renda had previously filed a lawsuit against the El Paso Water District on a first amendment retaliation claim and a breach of contract claim, and had obtained a \$4 million dollar judgment against it.

After being denied the Lubbock project, Renda filed suit against Lubbock in federal court, alleging a first amendment retaliation claim. The district court dismissed the claim, and Renda appealed to the Fifth Circuit.

The Fifth Circuit said that in order to state a first amendment retaliation claim, an employee must establish four elements: (1) that he suffered an adverse employment decision; (2) that the employee's speech involved "a matter of public concern;" (3) the employee's interest in commenting on matters of public concern outweighed the defendant's interest in promoting efficiency; and (4) the employee's speech must have motivated the employer's adverse action. Relying on previous Supreme Court and Fifth Circuit precedent, the court held an independent contractor with no previous relationship to the "employer" could nevertheless qualify as an "employee" under this standard. The court was more concerned with whether Renda's filing of a lawsuit against the El Paso Water District, in El Paso, was a matter of "public concern" to the citizens of Lubbock, so as to make their decision not to hire him rise to the level of a

⁷⁷ Tex. Prop. Code, §§ 162.001, *et seq.*

⁷⁸ 352 B.R. 707 (9th Cir. 2006).

⁷⁹ 11 U.S.C.A. § 523(a)(4)

⁸⁰ 956 F.2d 110 (5th Cir. 1992).

⁸¹ 463 F.3d 378 (5th Cir. Tex. 2006).

constitutional retaliation claim. The court said that the standard was whether the speech—that is, the El Paso lawsuit—fairly related to a “matter of political, social or other concern to the community.” They found that it did, because the suit in El Paso alleged wrongdoing by El Paso officials and because the lawsuit apparently involved a retaliation claim, as well. Although Lubbock was 450 miles from El Paso and Renda was headquartered in the Dallas/Fort Worth area, 300 miles to the east, the court nevertheless held that “even though the location of the protected activity and the place where the retaliatory activity occurred were hundreds of miles apart,” together those allegations were sufficient to put Lubbock on notice that Renda’s El Paso suit “involved more than Renda’s personal interests and implicated matters of public concern,” so as to allow his claims to survive a Section 12(b) dismissal motion.⁸² A petition for writ of certiorari has been filed by the city.⁸³

The dissent said that the case was nothing more than a state law question of whether Renda was the “lowest responsible bidder,” which could and should have been decided in state court, “where the court would be best able to determine, under Texas law, the scope of the City’s discretion in determining which bidders qualify as “responsible bidders.”⁸⁴

3. OSHA – Willful Violations

The Fifth Circuit held in *Chao v. OSHRC*, 2007 WL 519865 (5th Circuit Feb. 21, 2007) that multiple willful violations of the *OSH Act* cannot be grouped for assessing a penalty. Each separate willful violation must have a penalty assessed. (The statute provides for willful penalties between a minimum of \$5,000.00 and a maximum of \$70,000.00 for each violation.)

V. SOVEREIGN IMMUNITY

Sovereign immunity of the state and its political subdivisions is now firmly established by the Supreme Court's decision in *Tooke v. City of Mexia*.⁸⁵ For local governmental bodies the 79th Legislature waived immunity during its last session with the enactment of *Tex. Loc. Govt. Code* §§ 271.151, et. seq., effective for contracts entered into after September 1, 2005.

⁸² 463 F.3d at 383.

⁸³ No. 06-965, 2007 WL 98344 (U.S. Jan. 10, 2007).

⁸⁴ 463 F.3d at 387.

⁸⁵ 197 S.W.3d 325 (Tex. 2006) (holding that statutes stating that individuals and entities, public and private, may “sue and [or] be sued,” “[im]plead and [or] be impleaded,” “be impleaded,” “prosecute and defend,” “defend or be defended,” “answer and be answered,” “complain and [or] defend,” or some combination of those phrases, do not, merely by using such phrases, clearly waive a governmental entity's immunity from suit, overruling *Missouri Pacific Railroad Co. v. Brownsville Navigation District*, 453 S.W.2d 812 (Tex. 1970)). The Texas Supreme Court decided most of the other statutory waiver of immunity cases the same day, including a school district case, *Satterfield & Pontikes v. Irving I.S.D.*, 197 S.W.3d 390 (Tex. 2006), because similar “sue and be sued” language in Tex. Education Code § 11.151(a) did not effect a waiver.

In *Reata Construction Corp. v. City of Dallas*, the Court held that a public body's filing of a suit or counterclaim waived immunity only to the extent of allowing an offset to the extent of the City's claims.⁸⁶

Author's Note: Skipping legal analysis of the history and brittle logic of the Court's treatment of the topic and discussion of its obvious inequity, the current bottom line is that contractors have the right to litigate claims and disputes with cities, school districts and other local governmental bodies covered by *Tex. Loc. Govt. Code* §§ 271.151 et. seq., but when working for the State of Texas or its political subdivisions, they will be denied access to the courts and have no remedies beyond the "Mickey Mouse" procedures of *Tex. Govt. Code* § 2260.

⁸⁶ 197 S.W.3d 371 (Tex 2006). See also *City of Irving v. Inform Construction, Inc.*, 201 S.W.3d 693 (Tex. 2006) [same limited waiver for compulsory counterclaim] and *Port-Neches ISD v. Pyramid Constructors, LLP*, 201 S.W. 3d. 679 (Tex. 2006) [offset must be "germaine to, connected with, and properly defensive to the governmental entity's own claims".]