

Building A Foundation for Managing Complex Construction Law Issues in Texas

I. Recent Developments in Construction Law

A. Legislative Update

1. Mechanics Liens/Payment Bonds

HB 629 Relating to notice required for a mechanic's, contractor's, or materialman's lien in certain circumstances.

In *Page v. Structural Wood Components, Inc.*, 102 S.W.3d 720 (Tex. 2003), the Texas Supreme Court held that a subcontractor's deadline for filing a lien affidavit to perfect a retainage claim runs from the date the original contract was completed, terminated, or abandoned, even if the subcontractor had no knowledge as to when the original contract was terminated or abandoned. HB 629 remedies this problem by amending Texas Property Code Section 53.107 to require an owner to provide written notice to a subcontractor who has sent a lien notice or who has requested that the owner provide written notice whenever an original contract is either terminated or abandoned. If notice is not provided within ten days of termination or abandonment and the lien claimant otherwise properly perfects its lien claim, the owner will not be allowed to object on the grounds that an early termination or abandonment of the original contract shortened the subcontractor's time to perfect its lien claim. This provision does not apply to residential construction projects.

2. Construction – General

HB 265 Relating to the time for processing a municipal building permit.

This provision creates section 214.904 of the Local Government Code, and requires municipalities to issue building permits on a timely basis (statutory time periods are provided –

generally, 45 days to grant or deny). Failure to issue permits on a timely basis imposes obligations on the municipality to refund the permit fee.

HB 266 Relating to the time for processing a county building permit.

This provision creates section 233.901 of the Local Government Code, and requires counties (with populations of 3.3 million or more) to issue building permits on a timely basis (statutory time periods are provided – generally, 45 days to grant or deny). Failure to issue permits on a timely basis imposes obligations on the county to refund the permit fee.

SB 1458 Relating to the adoption of a uniform commercial building code for use in the state.

This provision amends section 214.211 of the Local Government Code to mandate the establishment of the International Building Code as the basis for all municipal and local governmental building codes for commercial construction. Cities will be able to modify code provisions (provided such modifications call for greater or more strict requirements). Code requirements are also extended after January 1, 2006, to all unincorporated areas, and counties are given ordinance making powers to enforce.

3. Construction – Licensing

HB 854 Relating to an action for damages alleging professional negligence by a registered professional land surveyor.

This provision amends section 150.001 of the Texas Civil Practice & Remedies Code, to extend the requirement for a certificate of merit as a condition for bringing a professional liability

claim against professional land surveyors.

HB 1573 Relating to the definition of the practice of architecture.

This provision amends section 1051.001(7) of the Texas Occupations Code to revise the definition of the practice of architecture for purposes of requiring an architectural license to include the following:

- (a) establishing and documenting the form, aesthetics, materials and construction technology for building construction or alteration;
- (b) preparing (or supervising and controlling the preparation of) architectural plans and specifications that include all integrated building systems and construction details;
- (c) observing construction to evaluate conformance with plans and specifications;
- (d) programming for construction projects, including identification of economic, legal, and natural constraints and determination of scope and spatial relationships of functional elements;
- (e) recommending and overseeing appropriate delivery systems;
- (f) consulting, investigating, and analyzing design, form, aesthetics, materials, and construction technology for construction or alteration, and providing expert opinion or testimony as necessary;
- (g) research to expand the knowledge base of the profession of architecture, including publishing and presenting findings in professional forums; and

- (h) teaching, administering, and developing pedagogical theory in academic settings offering architectural education.

HB 1573 also amends “Certificate of Merit” provisions in Chapter 150 of the Texas Civil Practice & Remedies Code to require the certificate as a pre-requisite for arbitration. HB 1573 also extends certificate of merit requirements for suits and arbitration proceedings against any firms in which such licensed professionals practice (not just in suits against individual licensed professionals) and expressly requires dismissal for failure to furnish a certificate of merit (dismissal with prejudice is authorized but not mandated). The certificate of merit requirement applies to any claim relating to professional services (not just professional negligence) other than a suit for the payment of fees. The revisions to Chapter 150 apply to licensed professional engineers as well as architects.

4. Construction – Public Works

HB 664 Relating to consideration of a bidder’s principal place of business in awarding certain municipal and school district contracts.

This provision creates section 271.9051 of the Texas Local Government Code, and amends section 44.033 of the Texas Education Code to give a city with a population under 250,000, and an independent school district which has its central administrative offices in a city with a population under 250,000, the authority to give a 5% preference for purchasing services when bid by a local contractor.

HB 908 Relating to a pilot program on the use of the reverse auction procedures by the Building and

Procurement Commission.

This provision adds section 2155.085 of the Texas Government Code, which instructs the Texas Building and Procurement Commission to use reverse auctions for the purchase of goods and services when procedure provides best value to the State or all purchasing methods provide equal value to the State. The Commission is required to set a goal of at least 20% of the dollar value of purchased goods and services to be procured by the reverse auction procedure. The Commission is also directed to offer HUB's special assistance and training relating to the reverse auction for construction or professional services; however, that provision was deleted in the final version of the bill.

HB 1826 Relating to the use of school district resources for the maintenance of real property not owned or leased by the district.

This provision adds section 11.168 to the Texas Education Code to prohibit school districts from contracting to perform private construction and maintenance with school district employees and property. This legislation was in response to school districts which were contracting as general contractors with third party owners for the construction of various public and private projects (unrelated to the construction or repair of the district's own school facilities).

HB 2659 Relating to bond requirements for privatized maintenance contracts.

This provision amends section 223.042 of the Texas Transportation Code to require the contractor to furnish a payment bond for a maintenance contract (the current statute only requires a performance bond).

HB 2661 Relating to the use of competitive sealed proposals for certain construction projects.

This provision amends section 252.043 and section 271.116 of the Texas Local Government Code, and authorizes local governmental entities on smaller highway type construction projects (under \$1.5 million) to use competitive the sealed proposal procurement method (rather than just competitive bidding).

SB 1544 Relating to purchasing practices of public junior colleges and community college districts.

This provision amends section 44.031 and Chapter 130 of the Texas Education Code to authorize junior colleges and community college districts to use alternative delivery systems (including design/build) and procurement procedures (including competitive sealed proposals) similar to those authorized for other educational institutions.

5. Construction – Claims on Governmental Projects

HB 1940 Relating to alternative dispute resolution of certain contract claims against the State.

This provision amends Chapter 2260 of the Texas Government Code (relating to dispute resolution procedures for state construction contracts) to expressly authorize recovery of delay damages (caused by the governmental entity). HB 1940 also expressly allows a contractor who has been sued by a governmental entity to seek recoveries by counterclaim without going through the procedural requirements of Chapter 2260, speeds up the procedural requirements for parties bringing action under the Chapter, and gives a party the right to appeal the administrative order on the basis of an abuse of discretion. It also modifies the provisions which control payment by the agency without additional legislative authorization – requiring such payment of an enforceable order if the

recovery is not greater than 25% of the contract.

HB 2039 Relating to the adjudication of claims arising under written contracts with local governmental entities.

This provision adds Subchapter I to Chapter 271 of the Texas Local Government Code to provide for an express waiver of sovereign immunity for claims arising from the sale of goods or services with local governmental entities. The statutory waiver of sovereign immunity in HB 2039 applies to all governmental entities, including municipalities, special purpose districts, schools and authorities, other than the State of Texas and counties. Under the statutory waiver provided by HB 2039, recoveries are limited (no consequential damages, exemplary damages, or home office overhead) and there is no waiver of sovereign immunity in federal court or for tort claims. HB 2039 went into effect on September 1, 2005; however, it was retroactive with regard to all claims against governmental entities to the extent that those entities had exercised sovereign immunity from suit prior to September 1, 2005.

HB 2988 Relating to waiver of sovereign immunity.

This provision amends section 311.034 of the Texas Government Code to provide that statutory requirements with regard to sovereign immunity, including notice provisions, are jurisdictional (which would allow an immediate appeal of the issue).

B. Recent Case Law

Page v. Structural Wood Components, Inc., 102 S.W.3d 720 (Tex. 2003).

Page hired Sepolio as a general contractor on a remodeling and expansion project for a building in Houston. Sepolio in turn retained several subcontractors including Structural Wood Components to provide labor and materials. Structural Wood completed its portion of the work in March 1998. Before the project was finished, Page and Sepolio had a dispute, and Page terminated his contract with the general contractor on April 14, 1998. Page then hired six new contractors to complete the construction. Since Structural Wood had not been paid in full, Structural Wood filed an affidavit claiming lien on the property on May 15, 1998, thirty-one days after Page had terminated his contract with Sepolio. Structural Wood subsequently filed suit to foreclose on its lien. After a bench trial, the trial court concluded that the work was completed on July 21, 1998, when the replacement contractors finished the project. The trial court held Page and Sepolio liable for Structural Wood's claims. *Id.* at 721. On appeal, the court of appeal also found that the project was complete in July 1998, and that Structural Wood's lien was timely. *Id.*

On appeal, the Supreme Court observed that the Texas Property Code required owners to maintain ten percent retainage until 30 days after the work was completed. The court noted that a subcontractor or other claimant against the retainage must properly give notice and file "an affidavit claiming a lien not later the 30th day after the work is completed." *Id.* at 722. The court then had to determine when the 30 day period ended. Page focused on the phrase "under an original contract" and contended that work under an individual contract should be deemed completed when the contract is terminated or abandoned, since no more work would be contemplated under the contract at that point. *Id.* at 722-23. Structural Wood focused instead on the word "contemplated" and argued that since the statute required "actual completion of the work ... reasonably required or

contemplated under the original contract,” a court should determine completion based on when all the work initially contemplated under the original contract was finished. *Id.* at 723. Structural Wood contended that Page’s interpretation would work a hardship on subcontractors who must file lien affidavits in a shorter time without ever knowing if an owner had terminated the general contractor. *Id.*

The Supreme Court concluded that the work ended when the contract was terminated, thus starting the 30 day period for the owner to hold retain retainage and for lien claimants to file their lien affidavits. *Id.*

Page v. Marton Roofing, Inc., 102 S.W.3d 733 (Tex. 2003).

In a companion case to *Page v. Structural Wood Components, Inc.*, 102 S.W.3d 720 (Tex. 2003), the Texas Supreme Court examined the funds trapping provisions of the Texas Property Code. The facts indicated that Page had hired Sepolio to remodel and expand a Houston building. Sepolio retained several subcontractors to including Marton Roofing to work on the project. After a dispute with Sepolio, Page terminated Sepolio’s contract on April 14, 1998, and hired six replacement contractors to finish the project. When Sepolio failed to pay, Marton sent Page a notice of non-payment on May 21, 1998, and filed a lien affidavit on June 15, 1998. Marton later filed suit against Page arguing that Page was liable for the unpaid invoices under both the statutory retainage provision of Texas Property Code section 53.103, and the fund trapping provision of Property Code section 53.081. The trial court granted Marton a summary judgment, which the court of appeals affirmed. *Id.* at 734.

The Supreme Court reversed relying on *Structural Wood* holding that since the work must

be defined in relation to a particular contract, a subcontractor must file its lien affidavit within thirty days of the time that the original contract is completed, terminated, or abandoned. Since Marton filed its lien affidavit two months after the original contract was terminated, the court held that Marton had failed to perfect a lien on the statutory retainage. *Id.*

The court also held that Marton did not perfect a fund trapping claim for similar reasons. The court stated that the statutory fund trapping provision allows subcontractors to “trap, in the owner’s hands, funds payable to the general contractor if the owner receives notice from the subcontractors that they are not being paid.” *Id.* However, here, the court found that Page neither made nor owed any further payments to Sepolio at any time after Page received notice of Marton’s claims. The court declared that as with retainage liens, fund trapping liens must be judged in relation to individual contracts. The court observed that Marton’s notice authorized Page to withhold funds from Sepolio, because Sepolio was the original contractor that hired Marton. Page was not authorized to withhold funds from the replacement contractors who had no relationship to Marton. As a result, the court held that Page could not be liable under the fund trapping statute for any funds paid to the replacement contractors. *Id.* at 735.

Advance’d Temporaries, Inc. v. Reliance Surety Co., 2004 WL 1632737 (Tex.App. – Corpus Christi 2004).

In a case of first impression, a temporary employment agency sought to collect from a payment bond surety for wages paid to temporary employees on a construction project. The trial court held that the agency had no standing to assert lien rights under Chapter 53 of the Texas Property Code. The agency had contracted with a subcontractor on an apartment construction project

to provide temporary employees for the subcontractor's use on the project. The agency invoiced the subcontractor weekly for as many as 100 employees. The agency paid the employees and withheld and processed appropriate payroll deductions. When the subcontractor did not pay the agency, the agency asserted a claim against the payment bond for the general contractor. After a bench trial, the trial court entered judgment in favor of the agency against the subcontractor, but against the agency in connection with its claims against the general contractor, the payment bond surety and the owner. *Id.* at **1.

On appeal, the agency challenged the trial court's determination that the agency was not a person entitled to the benefits of the mechanic's lien statutes. The agency contended that it was entitled to recover against the payment bond because through its contract with the subcontractor, the agency had provided labor in the direct prosecution of the work. The general contractor and the surety contended that the agency's services were payroll and administrative, and were not in the nature of labor or work as contemplated by the Property Code. *Id.*

The court of appeals reviewed the purpose and nature of mechanic's liens to determine the merits of the agency's claim:

In Texas, the law recognizes two forms of mechanic's liens: constitutional and statutory. The most common, applicable here, is found in chapter 53 of the Texas Property Code. Section 53.021 states:

(a) A person has a lien if:

(1) the person labors, specially fabricates material, or furnishes labor or materials for construction or repair in this state of:

(A) a house, building or improvement;

(B) a levee or embankment to be erected for the reclamation of overflow land along a river or creek; or

(C) a railroad; and

(2) the person labors, specially fabricates the material, or furnishes the labor or materials under or by virtue of a contract with the owner or the owner's agent, trustee, receiver, contractor, or subcontractor.

TEX. PROP.CODE ANN. § 53.021(a)(1), (a)(2) (Vernon Supp.2004). The purpose of the statutory mechanic's lien is to protect laborers and materialmen who come within its terms for labor and materials consumed in the construction of improvements to real property. *South Coast Supply Co. v. A & M Operating Co.* (In re A & M Operating Co.), 182 B.R. 986, 991 (Bankr.D.Tex.1993). No protection is afforded those who labor to produce or repair chattels. *Id.* A subcontractor in Texas is entitled to a lien when furnishing labor or materials for construction or repair of a building under or by virtue of a contract with the owner or the owner's subcontractor. TEX. PROP.CODE ANN. § 53.021(a)(1)(A), (a)(2) (Vernon Supp.2004). However, the statute is not designed to protect only subcontractors. Rather, the supreme court has held that "the mechanic's and materialman's lien statutes of this State will be liberally construed for the purpose of protecting laborers and materialmen." *Page v. Structural Wood Components*, 102 S.W.3d 720, 723 n. 3 (Tex.2003) (quoting *First Nat'l Bank v. Whirlpool Corp.*, 517 S.W.2d 262, 269 (Tex.1974)).

Id. at **2.

The court observed that the usual building contract imposed the duty to pay for labor and materials primarily on the contractor. *Id.* at **3. The court stated that when a subcontractor failed to perform its obligations, the loss should fall on the contractor, who should be supervising the subcontractor's activities. The court noted that a materialman's right to recover is not dependent on the status of the accounts between the general contractor and the subcontractor. *Id.* The court saw no distinction in the treatment for one who furnished labor. The court stated that otherwise it would "deprive those furnishing labor of substantial and certain benefits that the lien statutes are designed to provide. *Id.*

The court held that Chapter 53 of the Property Code protects those who "furnish labor" as well as those who actually labor on a construction project. *Id.*

Texas Wood Mill Cabinets, Inc. v. Butter, 117 S.W.3d 98 (Tex.App. – Tyler 2003).

Texas Wood Mill Cabinets was retained to design and build cabinets for a the construction of a speculative home. Texas Wood undertook its initial installation in May 1999, with additional work on June 17 and July 5, 1999. On June 18, 1999, the owner of the spec home entered into a contract entitled "New Home Contract (Incomplete Construction)" to sell the property to the Butters. The sale of the home closed on July 6, 1999. Texas Wood was not paid for its cabinets, and on October 11, 1999, Texas Wood filed an affidavit claiming lien as an original contractor. The same day, Texas Wood sent a copy of the lien to the original owner and the Butters by certified mail. On September 1, 2000, Texas Wood sued the Butters to foreclose on its lien. The Butters claimed that they were subsequent purchasers and had neither actual nor constructive notice of Texas Wood's lien

against the property. After a non-jury trial, the trial court granted judgment in favor of the Butters finding that the Butters were bona fide purchasers for value without actual or constructive knowledge of Texas Wood's cabinet work, and could not be bound by the lien. On appeal, the appellate court reversed.

The Butters contended that since a residential construction project was involved, the period for filing a lien was shortened by one month to the 15th day of the third month after the day on which the indebtedness accrued, as set out under Texas Property Code section 53.052(b). However, the court found that the home was constructed under a contract for a spec house, and not pursuant to a residential construction contract. As a result, the court declared that the one month longer period allowed by section 53.052(a) was applicable, and Texas Wood's lien was timely, if Texas Wood's work was completed after May 1999. The Butters contended that Texas Wood's work was completed in May 1999, and that all work after that related to specific adjustments requested by the original owner on work already billed for and abandoned by Texas Wood. The court interpreted the term "completed" to mean "ended" or "concluded." The court found that the cabinet contract could not be "completed" until the cabinets were constructed, installed, and functional. The court found that the adjustments that Texas Wood made in June and July were necessary, and a usual part of cabinet construction, since the base cabinets must be installed before appliances and other components of the kitchen. *Id.* at 105.

The court then examined whether the Butters had constructive notice of the lien. The court observed that once a lien affidavit has been properly filed, the lien relates back in time to the inception of the contract. *Id.* The court stated that when a lien affidavit is filed after the property is sold by the owner who contracted for the improvements, the purchaser is deemed to have

constructive notice of a contractor's right to assert a lien for the statutory period, even where the filing period commenced prior to the purchase. The court also noted that personal knowledge of improvements being made on the property shortly before the time the subsequent purchaser took possession of the property provides sufficient notice of a contractor's right to assert a lien claim. *Id.* The court found that the Butters had visited the house while it was under construction in June 1999, and held that the Butters had personal knowledge that improvements were being made to the property. The court held that the Butters' knowledge was sufficient to charge the Butters with constructive knowledge of Texas Wood's right to assert a lien claim during the statutory period. The court held that since Texas Wood's lien affidavit complied with statutory requirements and was timely filed, even if the Butters had no personal knowledge of the improvements, they were charged with constructive notice of Texas Wood's right to assert a lien for the statutory period. *Id.* at 106-07.

Dean v. Frank W. Neal & Associates, Inc., 2005 WL 1189173 (Tex.App. – Fort Worth 2005).

Homebuyers sued their construction contractor and engineer in connection with defects in the foundation of their home. The engineer had designed the home's foundation to accommodate potential movement of subsurface soils on the site. During construction, the engineer and the homebuyers noticed some cracks in the foundation. The engineer did not think that the foundation had been structurally compromised at that point and recommended that the cracks be repaired with an epoxy patch. Construction progressed and the homebuyers closed on the house in December 1996. After they moved in, the homebuyers noticed cracks in various places in the house. By October 1997, more cracks had appeared prompting a meeting of the contractor and the engineer to discuss how to resolve the problems. The homebuyers admitted that they were aware of the meeting

and the movement of soil as of October 1997. Between 1998 and 2002, there were more meetings concerning the repair of the foundation, and the homebuyers later testified that they believed that some or all of the parties involved in the design and construction of the foundation would pay for the repairs. At a meeting on January 23, 2002, the homebuyers discovered that there was no party willing to pay for the repairs, and the homebuyers filed suit 5 days later. The defendants moved for and secured summary judgment based on the passing of the statute of limitations.

The court first reviewed the discovery rule:

The discovery rule is a limited exception to the statute of limitations. *Computer Assocs. Int'l, Inc. v. Altai, Inc.*, 918 S.W.2d 453, 455 (Tex.1996). The discovery rule is applied when the nature of the injury is inherently undiscoverable. *Id.* at 456. Thus, the discovery rule should be applied only when "it is difficult for the injured party to learn of the negligent act or omission." *Id.* A cause of action accrues when the plaintiff knew or should have known of the wrongful injury. *KPMG Peat Marwick*, 988 S.W.2d at 749-50. A plaintiff need not know the full extent of the injury before limitations begins to run. *Murphy v. Campbell*, 964 S.W.2d 265, 273 (Tex.1997).

Id. at **2. The court noted that the Texas Supreme Court had analyzed the discovery rule and determined that:

the discovery rule does not linger until a claimant learns of actual causes and possible cures. Instead, it tolls limitations only until a claimant learns of a wrongful injury. Thereafter, the limitations clock is running, even if the claimant does not yet know:

- the specific cause of the injury;

- the party responsible for it;
- the full extent of it; or
- the chances of avoiding it.

Id. at **3 (quoting PPG Indus., Inc. v. JMB/Houston Ctrs. Partners Ltd. P'ship, 146 S.W.3d 79, 93-94 (Tex.2004)) (footnotes omitted).

The court determined that the homebuyers knew of foundation movement and problems in October 1997, and held that the statute of limitation began to run at that point. *Id.*

The homebuyers contended that they had raised fact issues as to whether the defendants were equitably estopped from asserting limitations since defendants' conduct induced the homebuyers to believe that defendants would pay for any necessary repairs to the home's foundation. The court recounted the elements of the doctrine of equitable estoppel:

(1) a false representation or concealment of material facts; (2) made with knowledge, actual or constructive, of those facts; (3) with the intention that it should be acted on; (4) to a party without knowledge or means of obtaining knowledge of the facts; (5) who detrimentally relies on the representations. *Johnson & Higgins of Tex., Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 515-16 (Tex.1998). Estoppel in avoidance of limitations may be invoked in two ways: either a potential defendant conceals facts that are necessary for the plaintiff to know he has a cause of action or the defendant engages in conduct that induces the plaintiff to forego a timely suit regarding a cause of action that the plaintiff knew existed. *Rendon v. Roman Catholic Diocese of Amarillo*, 60 S.W.3d 389, 391 (Tex.App.-Amarillo 2001, pet. denied).

The court stated that for the homebuyers to raise a fact issue on their estoppel by conduct

claim they must have presented some evidence that the defendants' conduct affirmatively induced them into delaying suit beyond the limitations period, unmixed with any want of diligence on their part. *Id.* at **4. The court noted that a plaintiff may not "blindly rel[y] upon a situation as being what it seemed rather than as being what it in reality was." *Leonard v. Eskew*, 731 S.W.2d 124, 129 (Tex.App.-Austin 1987, writ ref'd n.r.e.) (op. on reh'g). The court found that although there may have been an agreement among the defendants to undertake or pay for some repairs to the residence, there was not evidence that the homebuyers were personally aware of any specific payments from the defendants or that they were aware of any specific agreement among the defendants to pay for foundation repair to the home.

The court noted that an unsuccessful effort to make repairs does not toll the statute of limitations for purposes of determining when a cause of action accrued. (Citing, *Pako Corp. v. Thomas*, 855 S.W.2d 215, 219 (Tex.App.-Tyler 1993, no writ); and *Muss v. Mercedes-Benz of N. Am., Inc.*, 734 S.W.2d 155, 159-60 (Tex.App.-Dallas 1987, writ ref'd n.r.e.) (applying same rule to equitable estoppel case, but relying on case analyzing when cause of action accrued)).

The court declared that it had not found any cases in which the mere making of repairs, without more, estopped a defendant from asserting limitations. See, e.g., *Gibson v. John D. Campbell & Co.*, 624 S.W.2d 728, 730, 732-33 (Tex.App.-Fort Worth 1981, no writ) (holding that builder was estopped from asserting limitations when builder made initial repair to home and assured homeowner problem was repaired and, after homeowner discovered foundation problems, repeatedly assured homeowner that repairs would be made, sent agent to home to take out ruined carpet and floorboards, and offered to pay for forty percent of cost of replacement carpet). The court stated that it believed such a rule would discourage parties providing goods and services from extending

warranties and attempting to repair minor problems without first conducting an extensive investigation to determine liability. As a result, the court concluded that defendants' attempts to make initial repairs to the residence did not raise a fact issue as to equitable estoppel.

The court stated that absent fraud or bad faith, statements made during settlement negotiations do not waive a defendant's right to assert limitations. Compare *Lockard v. Deitch*, 855 S.W.2d 104, 105-06 (Tex.App.-Corpus Christi 1993, no writ) (holding statement in letter from defendant's insurance carrier to plaintiff stating, "Once you have the final specials and medical reports to submit to us for evaluation, we will try to work towards a settlement with you," did not raise fact issue on plaintiff's equitable estoppel claim) with *Frank v. Bradshaw*, 920 S.W.2d 699, 702-03 (Tex.App.-Houston [1st Dist.] 1996, no writ) (holding that insurance adjuster's statement to plaintiffs that if they sent him their bills, he would pay them, raised a fact issue as to whether defendant was estopped from asserting limitations). The court stated that defendants' seeking insurance coverage was not conduct that could have reasonably induced the homebuyers into delaying suit. On the contrary, the court observed that such conduct should have alerted the homebuyers that defendants thought the homebuyers' claims were actionable.

Without evidence to support their equitable estoppel theory, the homebuyers were unable to reverse the summary judgment against them for allowing the defendants to take years to discuss repairs to the home's foundation. *Id.* at **7.

II. Project Delivery Method Options and Answers

A. The Traditional Approach: Design/Bid/Build

In the traditional project, an owner selects an architect or engineer to design plans and

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

B. When Fast Track Construction Works Best

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

The principal advantage of fast track construction is time. The project starts well before the completion of the design and may even finish shortly after the last drawing is released. If all goes well, a project that is fast tracked may complete before the construction contract is even signed on

a traditional project. For those projects where time is real money, fast tracking is an option. If a manufacturing plant is needed yesterday, and construction has not yet begun, fast tracking may be viable. In the 1970's when inflation was out of control, fast tracking helped to avoid some of the price increases.

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

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

C. The Inherent Challenges in Multiple Primes

Well into the 1800's, the primary approach to construction was the “master builder” who not only designed the project, but also constructed it. For most of this century, however, construction projects have been managed jointly by the triumvirate of the owner, designer, and general contractor. Under this approach, the contractor and designer typically exercised day to day control, although the owner has at least nominal control, thanks to the power of its purse. (Remember the Golden Rule: He who has the gold makes the rules.) This traditional approach involved a single prime contractor who contracted directly with the owner. The general contractor then signed subcontracts with key trade contractors (electrical, mechanical, plumbing, etc.), and acted as the site manager during

construction. *See* Figure 1. The general contractor answered for the quality, cost, and timeliness of the work. The general contractor also assumed responsibility for site safety.

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

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

If the owner is not a sophisticated and effective manager, retaining multiple primes is an accident waiting to happen. Coordination problems are bound to arise if the work of each trade contractor is not scheduled appropriately. If the trade contractors mobilize only to discover that the project has not progressed sufficiently to accommodate them, or that another trade has had to disturb their work to do their own, there may be significant delay and disruption claims, and massive litigation. For example, in *Maintenance Corp. v. Rutgers*, 90 N.J. 223, 447 A.2d 906 (1982), the owner's contracts with each of several primes stated that time was of the essence. When delays occurred, and complex litigation began, the court held that each prime contractor was an intended

beneficiary of the owner's contracts with the other primes and had standing to sue the others for delay damages. The single biggest winners there were the lawyers.

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

D. Common Setbacks Arising in Design/Build Contracting

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

1. Design Build Team

Under the Design Build Team approach, an architect or engineer and a contractor join forces to form a joint venture to design and build a project. The team negotiates with an owner or submits a competitive proposal for both the project's design and construction. An advantage of this approach is the early involvement of the general contractor in the design phase. Having the contractor involved early allows for better coordination with the designer and among the various aspects of the design. The contractor and designer are motivated to work and play well together since they are

team members. This can also be a disadvantage. The designer no longer is principally the owner's agent, and is partners with the contractor. This disadvantage can also be an advantage if the owner makes both designer and contractor responsible for the ultimate project. The owner can then look to the team if anything is amiss, and avoid finger pointing between designer and contractor.

2. Sole Design Builder

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

3. Design Build Developer

With this approach, the owner contracts with a commercial developer, who usually lacks the credentials of a designer or a contractor. This approach is suitable for the owner who has little or no construction experience, and owns few other projects. The design build developer can supply the expertise to oversee the design and construction of projects for those owners who lack the necessary in-house staff. This way the owner can retain the experience necessary to develop the project properly, from selection of designer and contractor to handling of governmental permits and other matters. This form of design building is often used for build to suit projects.

4. Advantages

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

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

The principal pitfall of design building can be the design builder's weakness in anticipating the owner's needs for the project. Intense consultation and communication with the owner before the project design begins is incredibly important. Some design builders will move into an owner's existing projects for a lengthy period to assess and evaluate the efficiency and functionality of the project, consulting with the owner on a daily basis to discover and resolve problems. These consultations should involve the owner's lower management and persons actually performing the

owner's work. Otherwise, the owner may not even mention critical aspects of its operations, figuring that they were obvious. The owner may have developed improvements or have unique situations for which the design builder needs to account. For example, the owner may have handicapped workers who perform certain tasks. The design builder needs to ensure access for the handicapped workers. Time spent observing the owner's operations would have shown this need.

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

The design build approach also eliminates the checks and balances present when the designer and contractor are separate. Under the traditional approach, the designer will closely examine a contractor's performance to determine whether it meets specifications and justifies payment.

Contractors, on the other hand, may suggest value-engineering proposals if the design is too costly to construct. While the owner may pay more to separate design and construction responsibilities, many owners believe that these controls are worth the price.

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

5. Pricing

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

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

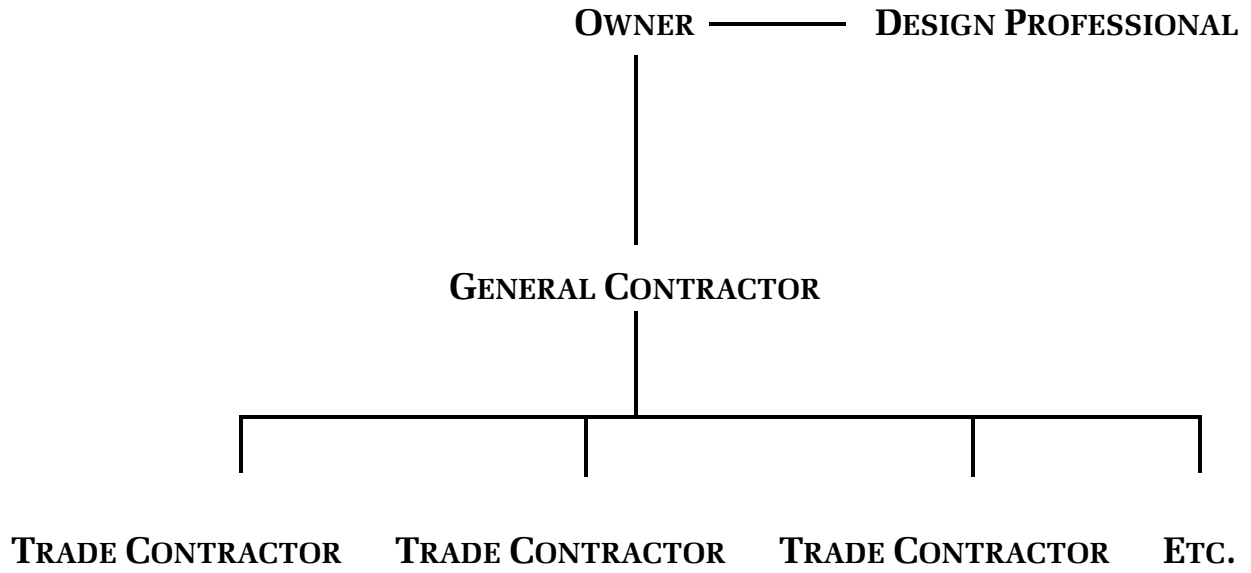


FIGURE 1. TRADITIONAL ORGANIZATIONAL CHART

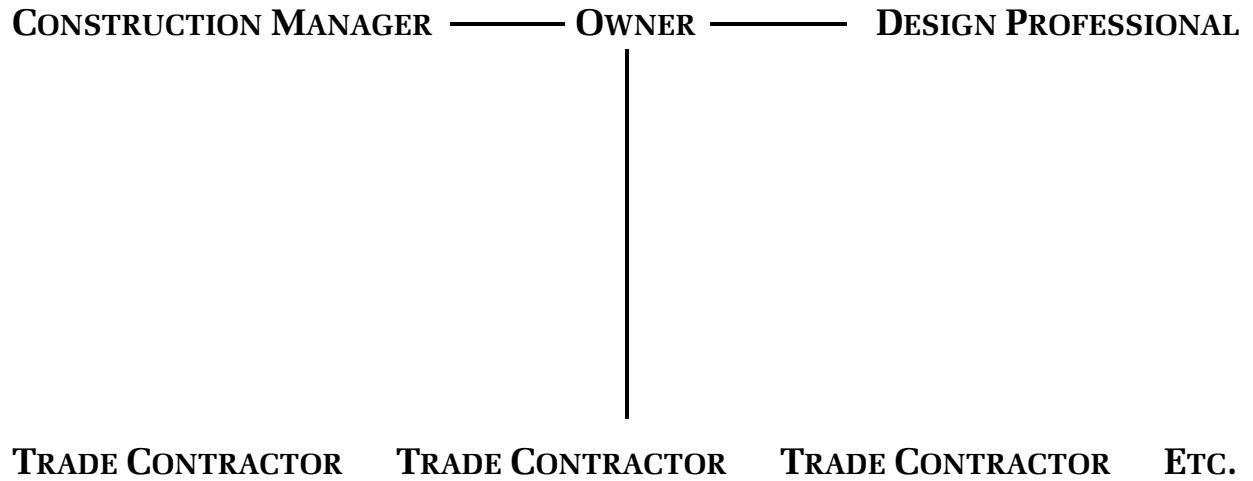


FIGURE 2. CONSTRUCTION MANAGER (SANS GENERAL CONTRACTOR) ORGANIZATIONAL CHART

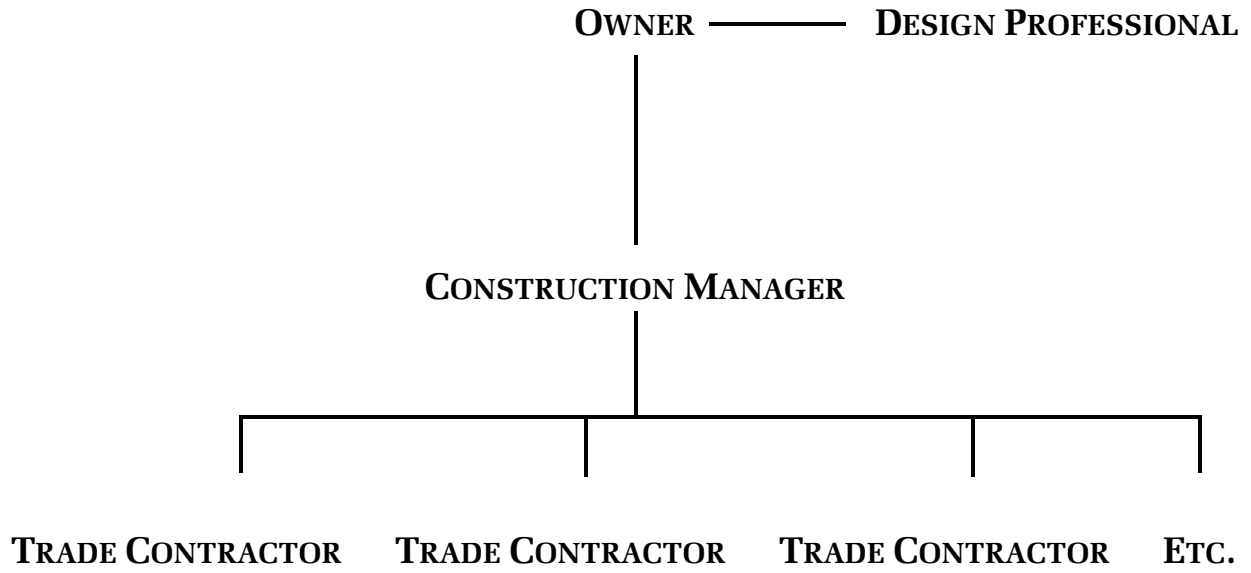
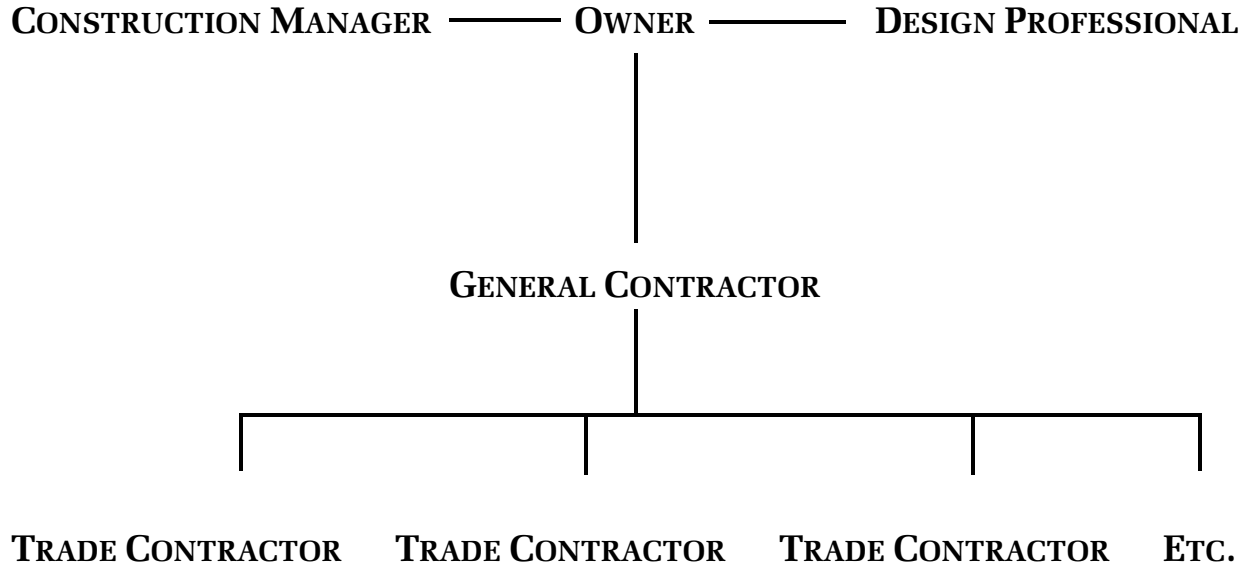


FIGURE 3. CONSTRUCTION MANAGER AT RISK ORGANIZATIONAL CHART



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

D. Common Setbacks Arising in Design/Build Contracting

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

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

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

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

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

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

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

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

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

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

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

F. Overcoming Obstacles When Implementing Best Value Procurements

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

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

professionals stretch taxpayer dollars.

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

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

1. Federal Construction Contracting

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

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

A. Two-Phase Procedure

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

(1) Phase 1

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

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

The FAR defines past performance information as:

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

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

favorably or unfavorably on past performance."

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

(2) Phase 2

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

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

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

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

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

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

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

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

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

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

3. Assessing the Advantages

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

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

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

4. Calibrating for Control

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

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

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

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

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

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

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

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

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

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

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

Typical best value source

selection factors

Life cycle costing/Total
cost of ownership

Quality of goods or
services

User friendliness

Proposed technical

performance

Financial stability of

vendor

Timeliness

Cost of necessary

training

Qualifications of

individuals

proposed for a

project

Realistic risk

assessment of the

proposed solution

Availability and cost of

technical support

Environmental impact

Past performance

Cost/price

G. Special Concerns for Public Works Projects

1. No implied duty of contractual good faith

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

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

2. Sovereign Immunity

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

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

3. Differing Site Conditions

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

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

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

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

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

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

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

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

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

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

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

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

the federal model.

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

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

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

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

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

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

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

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

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

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

4. Indemnity

If the owner requires indemnity for its own negligent acts, the owner cannot subtly demand it. Indemnity for one's own negligence must be expressly stated in the contract. In *Ethyl Corp. v. Daniel Construction Co.*, 725 S.W.2d 705 (Tex. 1987), the Texas Supreme Court announced the express negligence doctrine to avoid confusion in the interpretation and enforcement of indemnity provisions. Unless the owner writes the indemnity provision in clear black and white language, the contractor will not have to indemnify the owner for the owner's own negligence.

The standard AIA language like ¶3.18 in the A201 General Conditions will not satisfy the express negligence doctrine, since it does not mention the owner's negligence.

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

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

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

In *Dresser Industries v. Page Petroleum Co.*, 853 S.W.2d 505 (Tex. 1993), the Supreme Court stressed that an indemnity agreement must be conspicuous enough to provide “fair notice” of its term. To provide “fair notice,” an indemnity provision must be apparent to a reasonable person. A notation on the face of the contract which draws attention to the provision, such as all capital letters or contrasting type or color is sufficient.

In *Fisk Electric Co. v. Constructors & Associates*, 888 S.W.2d 813 (Tex. 1994), the court held that if an indemnity provision does not initially satisfy the express negligence doctrine, an indemnitor has no duty to indemnify another for their attorney’s fees even if the other were later found not to be negligent.

The Texas Civil Practice & Remedies Code §130.002 invalidates a provision which attempts to have a contractor indemnify an architect or engineer for liability and damage for personal injury, property damage, and expenses arising from the design professional’s negligence in preparing plans or specifications or in contract administration.

If the owner has required the contractor to indemnify the owner for the owner’s own negligence, the contractor should secure sufficient liability insurance to cover the risk. If the contractor cannot obtain such insurance, the contractor should seriously consider qualifying its bid

or not bidding at all. A Texas court has held that an agreement to cover a party's negligence also covers the party's gross negligence, which could result in punitive damage award in millions of dollars.

5. No Damages for Delay

Ordinarily, the owner is responsible for delays the owner causes to the contractor. For example, the owner may be responsible for obtaining rights of way on a project. If the owner does not obtain the rights of way in a timely manner and delays the work, the owner can be liable for the contractor's extra costs.

In *Anderson Development Corp. v. Coastal States Gathering Co.*, 543 S.W.2d 402 (Tex.Civ.App. -- Houston [14th Dist.] 1976, writ ref'd n.r.e.), the owner was to obtain the rights of way for the work. The parties had planned to do the work in the dry summer months. Because the owner failed to obtain the rights of way before the summer, the contractor had to perform the work in the fall in between rain storms. As a result, the work was performed sporadically as weather permitted and cost significantly more. The contractor did not complete work until three months after the scheduled completion date. The contractor successfully sued to recover its extra costs.

In *Board of Regents of the University of Texas v. S&G Construction Co.*, 529 S.W.2d 90 (Tex.Civ.App. -- Austin 1975, writ ref'd n.r.e.), the owner failed to provide proper plans and specifications. The work was delayed while the job was redesigned on a daily basis. The contractor incurred almost \$900,000 in extra costs as a result of the massive number of changes. The contractor successfully sued to recover the extra money. The court reasoned that the owner had caused the delays and increased the costs, and should pay for them.

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

contractor's extra costs arising from delays on project. Texas courts have upheld the no damages for delay disclaimer.

In *City of Houston v. RF Ball Construction Co.*, 570 S.W.2d 75 (Tex.Civ.App. -- Houston [14th Dist.] 1978, writ ref'd n.r.e.), the contractor received several hundred change orders and almost 900 design clarifications radically altering the plans and specifications for the project. The large number of changes was later held not to be within the contemplation of the parties when the project began. As a result of all the changes, the contractor incurred \$3 million in extra cost not including the direct costs of performing all the extra work. The contractor sued to recover the indirect costs of delay, disruption, general hindrance, and inefficiency.

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

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