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AS is always true in the area of construction law, the most significant cases arising during the survey period cut across a broad spectrum of legal issues. Contractual disputes and interpretations, personal injury and liability, governmental rights and immunities, competitive bidding procedures, and statutory enactments are among the items of interest promulgated in the past year. As always, the potential exists that the authors' view of what is and is not a noteworthy case may

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differ from the opinion of the reader, and apologies are therefore extended to those whose favorite case may have been omitted.

I. SOVEREIGN IMMUNITY

In the aftermath of *Federal Sign v. Texas Southern University*,[1] the issue of sovereign immunity continues to be a source of keen interest to contractors and the practitioners of construction law. In *Federal Sign*, the Texas Supreme Court indicated in a footnote that "[t]here may be other circumstances where the State may waive its immunity by conduct other than simply executing a contract so that it is not always immune from suit when it contracts."[2] Taking this footnote at face value, the Austin Court of Appeals has decided a number of recent cases, each touching on the *Federal Sign* footnote.

In *Aer-Aerontron, Inc. v. Texas Department of Transportation*,[3] the court held that the state had waived its sovereign immunity by its egregious conduct in ordering and accepting police radios and then refusing payment. Later, in *Little-Tex Insulation Co. v. General Services Commission*,[4] and *Texas Natural Resources Conservation Commission v. IT-Davy*,[5] the Austin court in both cases reinforced the position that the state can waive its sovereign immunity in a breach of contract action by its conduct, especially where the state accepts goods or services pursuant to a contract and then refuses payment.

A recent case in which the court did not find a waiver of the state's shield of sovereign immunity was *Tsumi, Inc. v. Texas Parks & Wildlife Department*.[6] This case involved an oral contract for the creation and distribution of mail-order gift catalogs. Prior to bringing suit, the contractor did not seek legislative permission to sue, nor did it contend that a statutory right to sue existed. Tsumi relied on the *Federal Sign* footnote and filed suit stating that the state through certain conduct had waived the protection of sovereign immunity. The court, while acknowledging this proposition, found that the contractor brought insufficient factual allegations to invoke the court's jurisdiction.

A majority of the cases decided by the Third Court of Appeals in Austin clearly indicate the fallout from the *Federal Sign* decision. The state's execution of a contract to pay for services rendered, coupled with its acceptance of those goods and services without paying for them, can be seen as a waiver of the state's immunity to be sued. As a result, sovereign immunity may not provide the categorical shield sought and expected by state agencies. However, as stated in last year's Survey, until this matter is settled, this area of construction law will continue to spark interest and

1. 951 S.W.2d 401 (Tex. 1997).
2. *Id.* at 408 n.1.
3. 997 S.W.2d 687 (Tex. App.—Austin 1999, no pet.).
4. 997 S.W.2d 358 (Tex. App.—Austin 1999, no pet.).
5. 998 S.W.2d 898 (Tex. App.—Austin 1999, no pet.).
6. No. 03-99-00205-CV, 2000 Tex. App. LEXIS 1265 (Tex. App.—Austin Feb. 25, 2000, no pet. h.), rule 53.7(f) motion filed (Apr. 10, 2000).

controversy. In addition to the case law, the Legislature attempted to address the issue of sovereign immunity during the 76th Legislative Session, which is discussed later in this article.

II. MECHANIC'S LIENS

The long-held Texas rule has been that where a construction contract is entered into by a lessee tenant, and not by the lessor owner, the lien rights of the contractor will be limited to a claim against the leasehold interest of the tenant. As a result, attempts to establish a lien on the owner's property are routinely rejected. Contrary to Texas case law going back decades, the Houston Court of Appeals has provided a new pathway for those providing improvements to a tenant to assert lien rights against the owner's fee estate.

In *Bond v. Kagan-Edelman Enterprise*,[7] the Court of Appeals reversed the trial court's decision and held that a tenant's contractor was entitled to a lien claim on the owner's entire shopping center. In *Bond*, the contractor was hired by the tenant to complete the interior construction of a restaurant. The court analyzed the case not only from the potential agency issue of the relationship between the tenant and the owner (consistent with the generalized exception), but also concentrated on the lease provisions between the owner and the tenant.

The *Bond* court found that because the lease contained specified contingencies related to the construction of certain improvements (which were to be completed by the tenant), the terms of the lease were in fact a general construction contract between the owner and tenant. The court concluded that the instrument did not become a lease until the fulfillment of the condition precedent (i.e., completion of the construction of the restaurant). Therefore, the court construed the owner-tenant relationship to be that of an owner-general contractor at the time of the filing of the lien. Consequently, the tenant's contractor was not limited to a claim against the tenant or the tenant's property interest, but was afforded the lien rights available to a lower-tier subcontractor claimant against the owner of the shopping center. In reaching such a conclusion, the *Bond* decision has lowered the apparent threshold that a contractor must pass in order to file a lien, not only on the leasehold interest of the tenant, but also on the fee interest of the owner.

III. FAIR NOTICE DOCTRINE

In *Douglas Cablevision IV, L.P. v. Southwestern Electric Power Co.*,[8] the Texarkana Court of Appeals followed the conspicuousness requirement of *Dresser Industries, Inc. v. Page Petroleum, Inc.*,[9] whereby ordi-

7. 985 S.W.2d 253 (Tex. App.—Houston [1st Dist.] 1999, no pet. h.) *reh'g overruled* (Feb. 25, 1999), Rule 53.7(f) motion filed (Mar. 31, 1999).
8. 992 S.W.2d 503 (Tex. App.—Texarkana, 1999, pet. denied).
9. 853 S.W.2d 505 (Tex. 1993).

nary risk-shifting clauses, such as indemnification provisions, must be conspicuous enough in their presentation for a reasonable person to have noticed them. The indemnification clause in *Douglas Cablevision* was not highlighted, in larger print, or underlined. Southwestern Electric Power ("SWEPCO"), the indemnitee, contended that the fact that the indemnification provision in its contract comprised two pages of a thirteen-page document in and of itself demonstrated it was a significant portion of the contract and, as such, was conspicuous.[10] The court rejected this argument, stating:

> All of the twenty-two numbered paragraphs, including paragraph seventeen which includes the indemnity provision, are printed in the same size and type of font. None of the paragraphs are preceded with any kind of descriptive heading. The actual language which requires Douglas to indemnify SWEPCO is contained in two sentences spanning roughly one-half page of a thirteen-page document. The indemnity provision was no more visible than any other provision in the agreement and does not appear to be designed to draw the attention of a reasonable person against whom the clause was to operate. We find that the clause was not conspicuous and did not comply with the fair notice requirement.[11]

In *Lexington Insurance Co. v. W. M. Kellogg Co.*,[12] it was held that the release of a contractor from liability for known and unknown claims did not apply to a contractor's future negligence. Therefore, the release did not need to comply with the Fair Notice Doctrine of *Dresser*. The case involved a dispute over a "closed-out" agreement after the contractor had already entered into a contract under which the contractor was to design, engineer, and construct an efethylene manufacturing facility. During the project, a dispute arose regarding the work performed by the contractor. At the completion of the project, the parties executed a "Project Close-Out Settlement Agreement" which provided that the owner would "hereby and forever release, acquit, and discharge [contractor] of and from any and all claims, actions or causes of action, known or unknown" arising out of the contract. The terms of the Agreement were challenged on the grounds that the release language was not sufficiently conspicuous to provide fair notice. The court respected the claim, and in doing so, pointed out that the requirements of *Dresser* specifically state that its decision "applies the fair notice requirements to indemnity agreements and releases only when such exculpatory agreements are utilized to relieve a party of liability for its own negligence *in advance*."[13]

The court emphasized that a "close-out" agreement releasing the contractor from liability was drafted and executed after the acts that could give rise to the liability were completed.[14] Further, the agreement was

10. *See Douglas Cablevision*, 992 S.W.2d at 507.
11. *Id.* at 509.
12. 976 S.W.2d 807 (Tex. App.—Houston [1st Dist.] 1998, pet. denied).
13. *Id.* at 809 (emphasis added).
14. *See id.*

signed after the construction of the plant had been completed, and the dispute arose during the construction, which was before the agreement was signed. Therefore, the *Lexington* court held that the Fair Notice Doctrine under *Dresser* was inapplicable to the case. The clear indication in *Lexington* is that the potential future discovery of "unknown" matters included within the release is alone insufficient to constitute an agreement or release "in advance."

IV. BIDDING

The San Antonio Court of Appeals upheld a clause in a bid package barring the contractor's claims against the architect based on the architect's evaluation or recommendation of the contractor's bid in *Sedona Contracting, Inc. v. Ford, Powell & Carson, Inc.*[15] In *Sedona*, a bidder's suit against an architectural firm that recommended rejection of its low bid on the grounds of tortious interference with business relations, defamation, and negligence, was dismissed on waiver grounds. The Northeast Independent School hired the architectural firm of Ford, Powell & Carson, Inc. to design and supervise the construction of improvements to a high school. Sedona Contracting, Inc. submitted the low bid. However, the architect recommended to the school district that it not award Sedona the contract, saying that the contractor was not qualified. Thereafter, Sedona presented evidence that it was a qualified and responsible bidder, but the contract was nevertheless subsequently awarded to the second lowest bidder.[16]

The court dismissed Sedona's claim for defamation and interference with its business relations, citing a clause in the bid documents which provided and required that "each bidder agrees to waive any claim it has or may have against the Owner, the Architect-Engineer, and their respective employees, arising out of or in connection with the administration, evaluation, or recommendation of any bid."[17] The appellate court held that Sedona's participation in the bidding process was consent not only to being rejected, but also to the possibility of an intentional tort.[18]

Sedona's alternative argument that the foregoing provision was against public policy and unenforceable was also rejected. The court disagreed with Sedona's interpretation, stating that:

> [i]f we were to open an architectural firm or engineering firm to liability for their recommendation, we would negate the process of finding a qualified contractor. We agree with [architect] that such a result would eviscerate the competitive bidding process, and relegate the process to a battle of numbers.[19]

15. 995 S.W.2d 192 (Tex. App.—San Antonio 1999, pet. denied).
16. *See id.* at 194-95.
17. *Id.* at 194.
18. *See id.* at 196.
19. *Id.* at 198.

V. SAFETY/PERSONAL INJURY/OSHA

In *Bright v. Dow Chemical Co.*,[20] the Houston Court of Appeals held that an owner who supervises an independent contractor's work for compliance or safety rules may be liable for injuries suffered by the contractor's employees. In this case, the plaintiff was a carpenter for the general contractor that was retained to build a gas compressor unit for the owner, Dow Chemical. The contract between Dow Chemical and the general contractor required that the contractor provide all materials and stated that the general contractor was an independent contractor.[21] The plaintiff's arm was crushed when a pipe fell as he was removing plywood forms for a concrete pier. The pipe that fell had been put in place by another employee of the general contractor, but the Plaintiff alleged that the owner was negligent in overseeing the work being performed by the general contractor on the project.

The plaintiff argued that Dow Chemical had the right to control and supervise the work and to oversee safety on the job site. The Court of Appeals noted that supervisory control, such as that alleged by the plaintiff, "must relate to the activity that actually caused the injury, and [must] grant the owner at least the power to direct the order in which the work is to be done, or the power to forbid it being done in an unsafe manner."[22] In this case, the owner's representative testified in a pre-trial deposition that he supervised the work being done to ensure that it was done safely, and that he had the authority to prevent the general contractor from doing work he felt was unsafe.[23]

The owner pointed out that the general contractor had its own safety representative on site who was responsible for seeing to it that all of the general contractor's employees complied with all applicable safety rules and requirements. However, the court stated that it could not ignore the evidence indicating that the owner retained some supervisory control over the general contractor's work on the premises. Since the owner had the power to forbid work being done in an unsafe manner, the court ruled that the owner owed a duty to the general contractor's employees to exercise supervisory control with reasonable care.[24]

In *Koch Refining Co. v. Chapa*,[25] the Texas Supreme Court overturned a decision holding that an owner's placement of a "safety man" on a job site creates a duty to employees of an independent contractor. The court relied on its holdings in *Hoechst-Celanese Corp. v. Mendez*[26] in responding to the claims that the owner's safety employees had instructed the independent contractor to perform in a safe manner, because requiring an independent contractor to "observe and promote compliance with

20. 1 S.W.3d 787 (Tex. App.—Houston [1st Dist.] 1999, no pet.).
21. *See id.* at 790-91.
22. *Id.* at 790.
23. *See id.* at 791.
24. *See id.*
25. 11 S.W.3d 153 (Tex. 1999).
26. 967 S.W.2d 354 (Tex. 1998).

Federal laws . . . and other standard safety precautions" does not impose an unqualified duty of care to ensure that an independent contractor's employees work safely.[27] Also, the Texas Supreme Court rejected the argument that the "possibility of control" by an owner constitutes evidence of the owner's "right to control" in *Coastal Marine Services v. Lawrence.*[28]

In *Laurel v. Herschap*,[29] the San Antonio Court of Appeals held a general contractor to be liable for two types of negligence in failing to keep the premises safe: (1) that arising from an activity on the premises, and (2) that arising from a premises defect. To recover on a negligent activity theory, the plaintiff would have to "establish that he was injured by or as a contemporaneous result of the activity itself rather than by a condition created by the activity."[30] The plaintiff testified at his deposition that he was injured by a falling pipe that fell less than sixty seconds after the general contractor's employee directed another subcontractor's employee to stop working.[31]

In this case, an employee of the subcontractor that supplied pipe to the general contractor was injured when a pipe fell on him during the course of the project . The allegation was made that an employee of the general contractor was responsible for the stoppage in moving the pipe supplies, which in turn caused the fall of the pipe onto the injured plaintiff. Given such facts, the Court of Appeals concluded that the plaintiff's injury was a contemporaneous result of the general contractor's employee's allegedly negligent activity of directing that the worker stop.[32] The court then went on to observe that a general contractor does not usually have a duty to insure that a subcontractor performs work in a safe manner. If, however, the general contractor exercises some control over the subcontractor's work, the general contractor may be liable unless it exercises reasonable care in supervising the activity. "Retaining the power to direct the order of the work to be performed or to forbid it from being performed in a dangerous manner is a sufficient exercise of control to give rise to a duty to exercise reasonable care."[33]

A court outside the jurisdiction of the state of Texas presented an interesting case regarding a job site inspection by the Occupational Safety and Health Administration ("OSHA"). In *L.R. Willson & Sons, Inc. v. Occupational Safety & Health Review Commission*,[34] a steel erection contractor was renovating the Orange County Civic Center in Orlando, Florida when Joseph Dear, then head of OSHA, happened to be staying in a hotel across from the civic center. From his hotel room, Mr. Dear viewed

27. *Koch*, 11 S.W.3d at 156.
28. 988 S.W.2d 223 (Tex. 1990).
29. 5 S.W.3d 799, 801 (Tex. App.—San Antonio, 1999, no pet.).
30. *Id.*
31. *See id.* at 802.
32. *See id.*
33. *Id.*
34. 134 F.3d 1235 (4th Cir. 1998), *cert. denied*, 525 U.S. 962 (1998).

the general contractor's employees working on the building without proper protection. Mr. Dear then called a local OHSA inspector to request an inspection of the site. Before going to the job site, the inspector came to the hotel and received permission from the management to go to the roof to videotape the employees who were not using proper protection. Thereafter, the inspector went to the job site and presented his credentials to the general contractor.[35]

The general contractor claimed that OSHA's off-site inspection (from the hotel roof across the street) violated its rights and asked that the evidence gathered be suppressed. The Occupational Safety and Health Review Commission determined that there was no violation of the employer's inspection rights. The Commission held that under section 8(a) of the Occupational Safety and Health Act, the requirement for an inspector to present credentials before inspecting or investigating applies only when the inspector makes an entry onto the site of the work and not to an inspection or an investigation conducted from an off-site location.[36] While inspections in the manner and circumstances of *Willson* may be uncommon, this case is of significant importance to general contractors' counsel on OSHA matters.

VI. LEGISLATIVE UPDATE—MECHANIC'S LIENS

In the recent legislative session, the Legislature revised chapter 53 of the Texas Property Code to clarify existing statutes concerning construction on residential properties and disclosure statements by amending the existing language in the Texas Property Code, as follows:[37]

1. The definition of "completion" from Section 53.106 to Section 53.001(15) was amended so that it applies to the entire Chapter 53, rather than just the subchapter relating to statutory retainage. It modifies the definition to make it clear that any type of replacement or repair of work performed under the contract will not affect the date of "completion" (only uncompleted work affects the date of completion);
2. Section 53.055(a) was amended by extending the period for sending the owner a copy of the affidavit claiming a lien from one business day to five calendar days after the date the affidavit is filed with the clerk;
3. Section 53.057 was amended to authorize claimants on residential construction projects to give the notice of contractual retainage in lieu of the Section 53.252 notice to owner (House Bill 740 had eliminated the notice of contractual retainage for residential construction projects);

35. *See id.* at 1237.
36. *See id.* at 1238-39.
37. Tex. H.B. 2054 §§ 1-14, 76th Leg., R.S. (1999) (to be codified as amendments to TEX. PROP. CODE ANN. ch. 53).

4. Section 53.158 was amended to clarify the limitations periods for non-residential and residential construction projects—for non-residential, the limitations period will be two years from the last day for the claimant to file its lien affidavit or one year from completion, abandonment, or termination of the original contract, whichever is later; for residential, the limitations period will be one year from the later of the last day for filing the affidavit or completion, abandonment, or termination of the original contract (the new wording would appear to apply to the "constitutional lien" as well);
5. Sections 53.205(a) and 53.206(a) and (b) were amended to provide that bonds protect all individuals with a claim that relates to a residential construction project under subchapter K and specifies that a person is not required to give notice to the surety under certain conditions;
6. Section 53.255 was modified relating to the initial disclosure statement to consumers, making it consistent with changes made in House Bill 2054 and to clear up several ambiguities (including a change in the language concerning "statutory retainage");
7. Section 53.256 was amended to permit the parties to waive the list of subcontractors and suppliers on a residential construction project (the contractor must obtain a written waiver in compliance with the requirements of the statute); and
8. Section 53.258 was amended (and simplified) to make provisions relating to the "periodic" disclosure on residential projects to require the contractor to provide the owner, prior to the receipt of requested funds, with a list of the subcontractors the contractor intends to pay from such requested funds.

The Legislature also expanded the coverage of mechanic's liens to labor and materials for installation of landscaping, irrigations systems, retention ponds, and similar dirt work.[38] As with the lien for architectural or engineering services, the "landscaping" labor and materials must have been furnished by the lien claimant pursuant to a written contract between the claimant and the owner (or its agent). In other words, a written contract is required, and the lien is limited to first tier (original contractor) claimants.

A new chapter 62 of the Texas Property Code was created to provide for a lien on real property for unpaid, earned commissions for commercial real estate brokers.[39] Commercial broker's liens will be perfected in a manner very similar to mechanic's liens (notice letter and filed affidavit claiming a lien). The commercial broker's lien attaches as of the date the affidavit claiming the commercial broker's lien is recorded (note: mechanic's liens relate back to visible commencement of construction).

38. Tex. H.B. 2135, §§ 1-4, 76th Leg., R. S. (1999) (to be codified as an amendment to TEX. PROP. CODE ANN. § 53.021).

39. Tex. H.B. 1052 §§ 1-2, 76th Leg., R.S. (1999) (to be codified at TEX. PROP. CODE ANN. §§ 862 *et seq.*).

The lien only applies to commercial projects, and a written agreement between the owner and the broker is required.

VII. RESIDENTIAL CONSTRUCTION

The Residential Construction Liability Act (chapter 27 of the Texas Property Code) was amended to, among other things, allow the defendant (contractor) to recover attorney's fees for groundless/bad faith claims and to require mediation of claims in excess of $7,500.[40] It also requires the claimant (consumer) to furnish the defendant (contractor) any available evidence of the nature and extent of the alleged defect and the required repairs. Failure to provide the defendant (contractor) with the notice of defect and a reasonable opportunity for inspection will result in the abatement of any claim under chapter 27. On the other hand, the cap on the contractor's liability is extended to the greater of the purchase price of the residence or the current fair market value of the property without the construction defect. Further, all contracts subject to chapter 27 must include a statutory disclosure informing the consumer of the mandatory provisions of chapter 27 (required notice and opportunity for inspection) as a prerequisite to any suit under the chapter for a construction defect.

VIII. PROMPT PAY ACT

The "Prompt Pay Statute" was amended for private works projects (Chapter 28, Texas Property Code).[41] It reduces the time (from 45 days to 35 days) for an owner to pay the contractor the amount "allowed under the contract" for properly performed work or furnished materials, including specially fabricated materials. It also gives contractors and subcontractors the right to suspend work (notwithstanding any provision in the contract to the contrary) for nonpayment upon ten days written notice to the owner (and the lender in some situations). A contractor or subcontractor who suspends work does not have to return to work until the amount wrongfully withheld is paid and the contractor or subcontractor is reimbursed for reasonable demobilization and remobilization expense. Further, a contractor or subcontractor who suspends work will not be liable for any costs or damages of such suspension unless the contractor or subcontractor was notified before suspension of a good faith dispute as to the funds withheld.

IX. SOVEREIGN IMMUNITY/DISPUTE RESOLUTION

State agencies are now required to establish dispute resolution proce-

40. *See* Tex. S.B. 506 §§ 1-10, 76th Leg., R.S. (1999) (to be codified as an amendment to TEX. PROP. CODE ANN. §§ 27 *et seq.*).

41. Tex. H.B. 1522 §§ 1-6, 76th Leg. R.S. (1999) (to be codified as an amendment to TEX. PROP. CODE ANN. §§ 28 *et seq.*).

dures for contractual disputes with contractors.[42] If these procedures fail to resolve the dispute, the contractor may request a contested case hearing before the State Office of Administrative Hearings. The contractor is limited to the recovery of unpaid contract funds and may not recover consequential damages, extended overhead, or attorney's fees. If the award is less than $250,000, the state agency is required to pay the award from appropriated funds. If the award is $250,000 or more, the administrative law judge must issue a written opinion with findings of fact and may recommend payment or rejection of payment, in whole or in part, to the Legislature. In the case of the larger award, the contractor will have to seek an appropriation from the Legislature for payment or consent from the Legislature to file suit against the State. This is obviously less than the contracting community was seeking in response to the sovereign immunity issue, but it does at least provide a mechanism for a contractor to obtain an impartial judicial determination of a breach of contract claim which will result in payment for the smaller awards and will enhance payment for the larger claims.

42. *See* Tex. H.B. 826 §§1-15, 76th Leg. R.S. (1999) (to be codified as amendments to TEX. GOV. CODE ANN. §§ 441 *et seq.*; TEX. LOCAL GOV. CODE ANN. §§ 2208 *et seq.*; TEX. GOV. CODE ANN. § 2209, *et. seq.*).