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Welcome to the Party Tex - The Spearin Doctrine Finally Adopted in Texas

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Welcome to the Party Tex

The Spearin Doctrine Finally Adopted in Texas

Presentation by David Mancini and Ben Deninger

October 2022

The *Spearin* Doctrine Finally Adopted in Texas

Overview of Today's Presentation: "The Spearin Doctrine is Adopted in Texas"

I. **Overview of the *Spearin* Doctrine**
   - What is it?
   - Where did it come from?
   - When and how is it now relevant?

II. **Previous Long Standing "Traditional Approach" Under Texas Law – *Lonergan***

III. **Recent Changes under Texas Law – *Tex. Bus. & Com. Code § 59.051***

IV. **Issues and Recommendations Under New Texas Law**

I. *Spearin* Doctrine Overview – Background

Background – Construction Contracts' Most Basic Terms

- **Scope of Work: Contracts define and allocate scope of work between / among parties.**
  - Design
  - Procurement / Materials / Equipment
  - Construction

- **Risk Allocation: Contracts expressly and *(far too often) implicitly* allocate between / among parties the *Responsibility, Risk and Potential Liability* associated with each scope item.**
- **Focus of this Presentation:**
  - General legal principles underlying the allocation of design responsibilities and liability risk.
  - How have those legal principles recently changed under Texas law?
  - How might these recent changes be implemented (and disputed) on future Texas projects?
  - Recommendations.

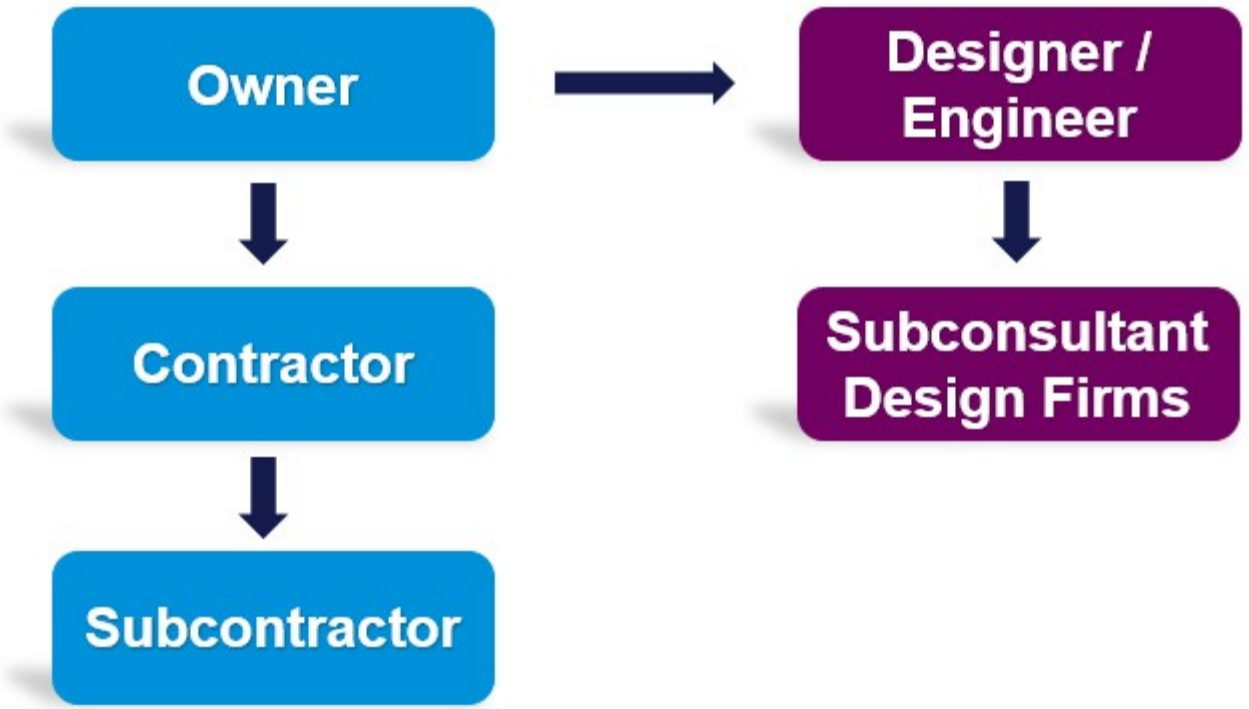
I. *Spearin* Doctrine Overview – Background (cont'd)

- **Parties to Contract and Project:**
  - Parties and their respective roles and scopes of work can vary greatly depending on the particular Project delivery method:
    - Traditional delivery method (design-bid-build)
    - Design Assist
    - Delegated Design
    - Design-Build / EPC

- **Focus of Today's Discussion:**
  - Our initial focus will be on design responsibility in contracts using the traditional delivery method.
  - The *Spearin* doctrine comes from a U.S. Supreme Court case where the parties contracted using traditional design-bid-build method.
  - Principles addressed today apply to all project delivery methods, depending on unique aspects of each project.

I. *Spearin* Doctrine Overview – What is it? Where did it come from?

- **The *Spearin Doctrine* arose out of a construction contract under the traditional design-bid-build delivery method**
- **Traditional Contractual Alignment:**



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I. *Spearin* Doctrine Overview – What is it? (cont'd)

Planned vs Problem Scenarios:

- **Planned Scenario:**
  - Owner/Design firm issues design documents that are perfect or at least adequate for the project to be built and function as planned, on schedule, on budget and without defects.
  - Contractor, in turn, executes and builds the project per the plans and specs.
- **Problem Scenario:**
  - Design documents have errors and omissions; project could not be built as designed or perhaps some aspect of the design failed, caused delay or cost increase, required rework or additional work, or was otherwise defective.
  - Questions arise: What party bears the risk of liability for errors or omissions in the design? Liable for what?
  - Owner? Design firm? Contractor?
- **"Problem Scenario" is precisely the case out of which the *Spearin* doctrine arose.**

I. *Spearin* Doctrine Overview – What is it? (cont'd)

Pre-*Spearin* "Traditional Approach" to Design Responsibility and Problems:

- **If a project design failed, Courts long ago held the Contractor responsible for design issues because the Contractor was responsible for the end result, regardless of whether the failure resulted from an Owner-provided design that was flawed, defective or incomplete.**
  - "[i]f what is agreed to be done is possible and lawful, it must be done. Difficulty or improbability of accomplishing the undertaking will not avail the defendant. It must be shown that the thing cannot by any means be effected." *The Harriman*, 76 U.S. 161, 172 (1869)

- **For almost fifty years, the Supreme Court's 1869 holding in the *Harriman* case governed such that the risk of errors and/or defects in an Owner-provided design fell exclusively on the Contractor….**
  - **…until the U.S. Supreme Court's decision in *U.S. v. Spearin*, 248 U.S. 132 (1918)**

I. *Spearin* Doctrine Overview – What is it? (cont'd)

- **Operative Facts in the *Spearin* case:**
  - **Project**:
    - Construction of a new dry dock in the Brooklyn Navy Yard and relocation of a storm sewer.
  - **Design**:
    - Government (Owner) contracted separately with a design firm to prepare all design documents.
    - Owner then gave the design documents to bidders for the construction scope.
    - Bidders had an express contractual duty to check the plans.
  - **Damage and Design Defect**:
    - During construction, heavy rains caused a nearby dam (*not shown on the Owner-provided plans*) to fail, causing water to flood into the ongoing dry dock excavation and newly installed sewer. The sewer and excavation were damaged and required significant repair.
    - Owner directed the Contractor to repair the sewer at Contractor's own cost.
    - Contractor discovered that the Government knew the sewers tended to overflow from time to time and flood the dry dock area, but failed to account for this water flow in the Owner-provided design or disclose this fact to Contractor.
  - **Dispute**:
    - Contractor refused to make the repairs unless the Owner (1) changed the design; and (2) paid for the repair work.
    - Owner terminated the Contractor and sued the Contractor for the repair costs.

I. *Spearin* Doctrine Overview – What is it? (cont'd)

- ***Spearin* Court Rules in Contractor's Favor:**
  - Supreme Court held the Owner responsible for the insufficiency of the sewer design plans and dry dock excavation because Contractor was bound to build the sewer and dry dock in accordance with the Owner-provided design.
  - Underlying contract created an "implied warranty" of the Owner-provided sewer design; Owner "imported a warranty that if the specifications were complied with, the sewer would be adequate."
  - Contractor's contractually stated duty to "examine the site" and to "check plans did not impose the obligation to pass upon their adequacy to accomplish the purpose in view."
  - Both aspects of the *Spearin* ruling are critical: (1) Owner-proved design created an implied warranty, and (2) Contractor duties to check plans and examine the site did not shift Owner's design responsibility.

- ***Spearin* was a federal question case:** Ruling in *Spearin* applied only to contracts issued by the federal government. It did not apply to contracts involving state or local governments or agencies, nor did it apply to private/commercial contracts.

I. *Spearin* Doctrine Overview – How is it used?

- **Evolution of *Spearin* to State Courts and State Law:** Because *Spearin* arose from a public project owned by the Federal Government, state courts initially only applied *Spearin* to state and local public projects.
  - Vast majority of states subsequently adopted the *Spearin* doctrine:
    - **California**: *Souza & McCue Const. Co. v. San Benito Cty.,* 57 Cal.2d 508, 510-511 (1962)
    - **Florida**: *Jacksonville Port Auth. V. Parkhill-Goodlow Co., Inc.*, 362 So.2d 1009, 1012 (Fla. 1st DCA 1978)
    - **Maine**: *Marine Colloids, Inc. v. M.D. Hardy, Inc.,* 433 A.2d 402, 406 (Me. 1981)
    - **Oregon**: *Gilbert Pac. Corp. v. State By & Therough Dep't of Transp., Hwy. Div.,* 822 P.2d 729, 732 (1991).

- **Over time, most states have come to apply *Spearin* to *both* public and private projects.**
  - *E.g.,* Louisiana: *Keller Constr. Corp. v. George W. McCoy & Co.,* 119 So.2d 450, 457 (La. 1960)
- **However, a few states that have adopted *Spearin* continue to limit *Spearin* to public projects only.**
  - *E.g.,* Ohio: *AP Alternatives, LLC v. Rosendin Electric, Inc.,* 2019 WL 3858654, * 6 (N.D. Ohio 2019)

I. *Spearin* Doctrine Overview – How is it used? (cont'd)

Spearin as a Defense against Claims by Government Entities or as a Basis for Contractor Affirmative Claims?

- **_Spearin_ Was Initially Used by Contractors Only as a Defensive Tool:**
  - At first, the *Spearin* doctrine was used defensively against claims by the Owner for repair costs for rework and other damages caused by an owner-provided defective design.
- **_Spearin_ Was Later Used by Contractors as Offensive Claims Tool:**
  - Contractors over time came to use *Spearin* as a basis to recover Direct, Indirect and Delay damages caused by errors in Owner-provide design plans/specifications.

Owner Limitations or Disclaimers on the *Spearin* Doctrine:

- **Owner Attempts to Circumvent _Spearin_ Have Generally Failed*:***
  - Owner's have attempted to shift the design risk back to Contractors by imposing (1) contract requirements for Contractors to assist with design or perform design reviews, (2) adding disclaimers of accuracy of completeness, and (3) asserting contract design information was "for information only" and "could not be relied upon."

I. *Spearin* Doctrine Overview – Exceptions

- **However, Courts Do Recognize Certain Limited Exceptions to the *Spearin* Doctrine.**

- **Courts may allow Owner's to Shift Design Risk to Contractors when Contract Terms are Clear, Specific, Narrow and Limited:**
  - **Design-Build Contracts**: Alternative project delivery method such as Design-Build or EPC where Owner contracts with one entity that provides both design and construction.
  - **Performance vs Design Specification**: Contract sets forth a "Performance Specification," whereby Contractor must achieve a specified performance criteria, while also giving Contractor the discretion to determine how that performance criteria is to be achieved. *E.g., Stuyvesant Dredging Co. v. U.S.*, 11 Cl. Ct. 853, 859-61 (Cl.Ct. 1987).
  - **Delegated Design Contract Terms**: Where specific scopes of the project design are expressly and clearly delegated "downstream" to the Contractor or another entity, and responsibility for the delegated design scope is made clear.
  - **Design Assist**: Where Owner requires Contractor's design assistance, but not design responsibility, Owner generally retains design responsibility and risk.

II. Traditional Texas Approach to Design Risk – *Lonergan*

- **Texas Standard for Allocating Design Risk**: In 1907, over a decade before *Spearin* (1918), the Texas Supreme Court had already addressed liability for Owner-provided design plans / specifications in *Lonergan v. San Antonio Loan & Trust Co.,* 104 S.W. 1061 (Tex. 1907).
- **Relevant Facts**: *Lonergan* involved a private project – a new bank building – and although the Contractor performed its work according to Owner's design, the building collapsed prior to completion, the Contractor refused to repair it and eventually abandoned the Project.
- **Dispute**: Owner sued Contractor for the Repair Costs.
- **Contractor's Defense**: In defense to Owner's lawsuit, Contractor alleged the collapse was caused solely by *defects in plans furnished by Owner*.
- **Contractor's Rationale**: Owner provided an implied warranty of sufficiency for its design plans.
- **Court Holds for Owner**: In dismissing the implied warranty concept, the Texas Supreme Court held:
  - Any obligation of Owner for sufficiency of its design plans "*must be found expressed in the language of the contract*, or there must be found in that contract such language as will justify the court in concluding that the parties intended that the [Owner] should guarantee the sufficiency of the specifications."

II. Traditional Texas Approach to Design Risk – *Lonergan* (cont'd)

Texas Court's Rationale in *Lonergan* Firmly Established Its Legal Principle

- **Under *Lonergan*, neither the Owner nor the Contractor give implied warranties of suitability of the design**
  - Rather, both parties are equally positioned for purposes of evaluating the design specifications.
  - However, *by submitting a bid*, the Contractor implicitly agrees to build that which is contemplated by the design for a specified price and take full responsibility for contract's intended scope.

- ***Lonergan* expressly clarified that the Contractor's design liability "does not rest upon a guaranty of the specifications, *but upon his failure to perform his contract to complete and deliver the structure*." *Id.* at 1067.**

II. Traditional Texas Approach to Design Risk – *Lonergan* (cont'd)

Lonergan Holding Was Then Applied to Texas Public Projects:

- **Although Lonergan arose from a private project, its logic was later applied to public projects in Texas quite broadly. See *McDaniel v. City of Beaumont*, 92 S.W.2d 552, 561 (Tex. Civ. App. 1936)**
  - "The owner has the right to submit to prospective bidders any character of plans and specifications for the erection of his building. The *bidder himself must know the nature of the plans and specifications, and must decide for himself whether or not, by the due execution of the plans and specifications, he can erect and deliver to the owner the character of building called for by the contract*. […] There is no law compelling him to submit his bid, but, if he bids, he must execute his contract or respond in damages.'"

- **Texas Supreme Court Reaffirms *Lonergan* in the 21st century:**
  - *El Paso Field Servs., L.P. v. MasTec N. Am., Inc.,* 389 S.W.3d 802, 822 (Tex. 2012) (holding for Owner)
    - "In *Lonergan* […] we held that for an owner to be liable to a contractor for a breach of contract based on faulty construction specifications, the contract must contain terms that could fairly imply the owner's guaranty of the sufficiency of the specifications, which were provided to the owner by an architect. *Here, as in Lonergan, [Owner] did not guarantee the accuracy of [Engineer's] alignment sheets*." Contractor there assumed the design risk.

II. Traditional Texas Approach to Design Risk – Exceptions to *Lonergan*

- **Exceptions to *Lonergan*:**
  - Typically, Texas courts would only find Owner's responsible for design errors where the underlying contract expressly places such responsibility on them and not on the Contractor.
    - *Alamo Comm. College Dist. v. Browning Constr. Co.,* 131 S.W.3d 146, 154-55 (Tex. App. 4th 2004).

- **Confusion Arose and Persisted:**
  - Over the decades since *Lonergan*, shrewd contractors in Texas have attempted to contract around its requirements *(e.g., stating contractor's bid price relied upon the accuracy of owner's design documents; stating contractor only checked owner's design for obvious defects).* Such unique contract terms often bred confusion as that approach often yielded differing results:
    - *Emerald Forest Util. Dist. v. Simonsen Constr. Co.,* 679 S.W.2d 51 (Tex. App. 14th 1984).
    - *Shintech Inc., v. Group Constructors, Inc.,* 688 S.W.2d 144 (Tex. App. 14th 1985).

II. Traditional Texas Approach to Design Risk – Confusion with *Lonergan*

- **Confusion Implementing *Lonergan* also arose with Affirmative Contractor Claims Based on Design Errors:**
  - In spite of *Lonergan*, confusion arose regarding whether an Owner's flawed or defective design documents gave Contractors an affirmative cause of action to recover damages:
    - *See City of Baytown v. Bayshore Constructors, Inc.,* 615 S.W.2d 792 ,793 (Tex. Civ. App. 1980).
    - *See Newell v. Mosley,* 469 S.W.2d 481, 483 (Tex. Civ. App. 1971).

- **Despite confusion, specific terms still control over general terms:**
  - *See, e.g., Millgard Corp. v. McKee/Mays,* 49 F.3d 1070 (5th Cir. 1995).

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law

- **In 2021, the Texas legislature enacted a new law –**
  - *Tex. Bus. & Com. Code, Chapter 59* – entitled *"Responsibility for Defects in Plans and Specifications"*
  - Chapter 59 has only 5 sections, but they pack a punch
- **The Key Provision changing Texas law is found at § 59.051(a):**
  - "A contractor is not responsible for the consequences of design defects in and may not warranty the accuracy, adequacy, sufficiency, or suitability of plans, specifications, or other design documents provided to the contractor by a person other than the contractor's agents, contractors, fabricators, or suppliers, or its consultants, of any tier." *Tex. Bus. & Com. Code § 59.051(a).*
  - Broadly stated, where the new law applies, contractors are no longer responsible for design defects in Owner-provided design documents.
- **Limitations:** As a whole, Chapter 59 also imposes several important limitations on the otherwise broad language of § 59.051(a) which will be addressed herein.
- **Case Law Interpreting § 59.051(a)?** Unfortunately, as with most new statutes, § 59.051(a) has yet to be interpreted in any published Texas decisions.

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

- **This presentation will discuss the following unique aspects of the new law in more detail:**

  A. **Effect on Prior Texas Construction Law** – How does the new law change the law previously set forth in *Lonergan* and its progeny?

  B. **Scope of Projects and Parties Affected** – What projects and contracts are covered by the new law and which are exempt?

  C. **Specific Duties of Contractors** – What duties does the new law impose on Contractors?

  D. **Prohibitions on Contract Terms** – What contract language is prohibited by the new law?

  E. **Enforcement Penalties** – What are the penalties for violating the requirements of the new law?

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

A. Effect on Prior Texas Construction Law?

- **How does the new law change the law set forth in *Lonergan* and its progeny?**
  - Under *Lonergan*, the rule in Texas was that the Owner and Contractor are equally positioned to evaluate design specifications, and *by submitting a bid*, the Contractor is agreeing to build that which is contemplated by the design.
  - Was this an accurate assumption?
  - Were Owners and Contractors equally positioned to evaluate the Owner's design?
  - When submitting a bid, do Contractors intend to take on the design risk?
  - How could Contractor's price design risk?
- **Legislative Intent:**
  - In drafting the new law, the Texas legislature explained its intent to shift away from the *Lonergan* approach.
  - It is reasonable for Contractors to rely on plans/specs provided to the Owner without liability for defects therein.
    - New law "provides that a builder is not responsible for the consequences of defects in design or bid documents provided to the builder by the person with whom the builder has entered into a construction contract." *2021 Texas Senate Bill No. 219*, Texas Eighty-Seventh Legislature.

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

B. Scope of Projects and Parties Affected

- **What Projects are covered by § 59.051?**
  - "This chapter applies only to a contract for the construction or repair of an improvement to real property." *Tex. Bus. & Com. Code Ann. § 59.002(a)*.
- **What Projects are Exempt from § 59.051?**
  - There are 4 key exemptions from the new law.

➢ **Exemption #1: Critical Infrastructure Facilties**

- "This chapter does not apply to a contract entered into by a person for the construction or repair of a *critical infrastructure facility* owned or operated by the person or any building, structure, improvement, appurtenance, or other facility owned by the person that is necessary to the operation of and directly related to the critical infrastructure facility." *Tex. Bus. & Com. Code Ann. § 59.002(b)*.

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

B. Scope of Projects and Parties Affected (cont'd)

- **Exemption #1: Critical Infrastructure Facilities *(cont'd)***
  - **What is a Critical Infrastructure Facility?** The new law defines the term with 24 categories of projects listed in *§ 59.001(3)(A)-(X)* and summarized by the following:
    - **Energy:** (a) petroleum/alumina refinery; (b) electrical power generating facility/substation; (e) natural gas compressor; (f) LNG terminal/storage facility; (i) has processing/treatment plant; (n) and (t) pipelines; (o) oil/gas drilling site; (p) crude oil storage tanks; (q)-(s) oil/gas production facility, wellhead or facility with active flare; (u) utility-scale electrical distribution facilities; (w) facilities used to manufacture or produce fuels
    - **Manufacturing:** (c) chemical/polymer/rubber manufacturing facility; (k) steelmaking facility
    - **Water/Wastewater:** (d) water intake/treatment/pumping facility; (l) high-hazard dam; (v) utility-scale water/wastewater storage, treatment or transmission facilities
    - **Communications:** (g) telecommunications structure; (j) radio/TV transmission facility
    - **Transit:** (h) freight transport facilities – i.e. port/railyard/trucking terminal; (x) commercial airport facilities
    - **Farming:** (m) concentrated animal feeding operation

- **Chap. 59 does not define what facilities are *directly related to* Critical Infrastructure Facilities.**

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

B. Scope of Projects and Parties Affected (cont'd)

➢ Exemption #2: Design-Build Contracts

- Design Build contract means "a contract in which a contractor agrees to: (A) construct, repair, alter, or remodel and improvement to real property; and (B) be responsible for the development of plans, specifications, or other design documents used by the contractor to construct, repair, alter, or remodel the improvement." *Tex. Bus. & Com. Code Ann. § 59.001(5).*
  - New law DOES NOT apply to construction, repair, alteration, or remodeling performed "under a *design-build contract* and the part of the plans, specifications, or other design documents for which the contractor is responsible under the contract is the part alleged to be defective." *Tex. Bus. & Com. Code Ann. § 59.002(c)(1).*

➢ Exemption #3: EPC Contracts

- EPC contract means "a construction contract where the contractor is responsible for all of the engineering, procurement, and construction activities to deliver the completed project." *Tex. Bus. & Com. Code Ann. § 59.001(6).*
  - The new law DOES NOT apply to construction, repair, alteration, or remodeling performed "under an *engineering, procurement, and construction contract* and the part of the plans, specifications, or other design documents for which the contractor is responsible under the contract is the part alleged to be defective." *Tex. Bus. & Com. Code Ann. § 59.002(c)(2).*

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

B. Scope of Projects and Parties Affected (cont'd)

➢ **Exemption #4: – Contracts where the Contractor Gives Design Input/Guidance**

- Design Input/Guidance contracts means "any portion of a contract between a person and a contractor under which the contractor agrees to *provide input and guidance* on plans, specifications, or other design documents." *Tex. Bus. & Com. Code Ann. § 59.002(d).*
  - Frequently referred to as "design assist" contracts.

- **However, such contracts are only exempt from § 59.051 to the extent that:**
  - "(1) the contractor's input and guidance are provided as the signed and sealed work product of a person licensed or registered under Title 6, Occupations Code," and
  - (2) "the work product is incorporated into the plans, specifications, or other design documents used in construction." *Tex. Bus. & Com. Code Ann. § 59.002(d)*

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

C. Specific Duties of Contractors that, if breached, may impose Liability on Contractor for Defective Design

- **Notice of Known Design Defect:** Contractor must notify the Owner when it learns of, or reasonably should have discovered – in its capacity as a Contractor and utilizing Ordinary Diligence – a design defect in the applicable plans, specifications or design documents
  - "A contractor must, within a reasonable time of learning of a defect, inaccuracy, inadequacy, or insufficiency in the plans, specifications, or other design documents, disclose in writing to the person with whom the contractor enters into a contract the existence of any known defect in the plans, specifications, or other design documents that is *discovered by the contractor, or that reasonably should have been discovered by the contractor using ordinary diligence, before or during construction*." *Tex. Bus. & Com. Code § 59.051(b)*.

- **Penalty for Failure to Disclose a Defect:**
  - "A contractor who fails to disclose a defect as required by Subsection (b) may be liable for the consequences of defects that result from the failure to disclose." *§ 59.051(c)*.

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

C. Specific Duties of Contractors that, if breached, may impose Liability on Contractor for Defective Design (cont'd)

- **What is the "*Ordinary Diligence*" expressly required in § 59.051(b) above*?***
  - "[T]he observations of the plans, specifications, or other design documents or the improvement to real property that a contractor would make in the reasonable preparation of a bid or fulfillment of its scope of work under normal circumstances." *Tex. Bus. & Com. Code § 59.051(b)*.
- **Does "*Ordinary Diligence*" require a Contractor to Engage a Design Professional?**
  - ***No***. "Ordinary diligence does not require that the contractor engage a person licensed or registered under Title 6, Occupations Code, or any other person with specialized skills. A disclosure under this subsection is made in the contractor's capacity as contractor and not as a licensed professional under Title 6, Occupations Code." *Tex. Bus. & Com. Code § 59.051(b)*.
- **What is the Applicable Standard of Care and What is meant by "scope of work under normal circumstances?"**
  - "Normal Circumstances:" If scope is limited to construction, should be industry standard for a Contractor in similar circumstances.
  - However, if the Contractor is deemed to have assumed responsibility for any design services, the Contractor's design work is subject to the same general standard of care for design professionals in Texas per § 59.052.
  - Design "services [shall] be performed with the professional skill and care ordinarily provided by competent architects or engineers practicing under the same or similar circumstances and professional license." *Tex. Civ. Prac. & Rem. Code § 130.0021*.

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

C. Specific Duties of Contractors that, if breached, may impose Liability on Contractor for Defective Design (cont'd)

- **Texas Contractors' Duty to Notify of Design Defects Matches Common Industry Practices**
  - § 3.2.2 of the A201 – a widespread contract form promulgated by the American Institute of Architects states:
    - "…Contractor shall, before starting each portion of the Work, carefully study and compare the various Contract Documents relative to that portion of the Work, as well as the information furnished by the Owner… shall take field measurements of any existing conditions related to that portion of the Work, and shall observe any conditions at the site affecting it. These obligations are for the purpose of facilitating coordination and construction by the Contractor and are not for the purpose of discovering errors, omissions, or inconsistencies in the Contract Documents; however, the *Contractor shall promptly report to the Architect any errors, inconsistencies or omissions discovered by or made known to the Contractor* as a request for information in such form as the Architect may require. It is recognized that the *Contractor's review is made in the Contractor's capacity as a contractor and not as a licensed design professional, unless otherwise specifically provided*…"

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

D. Limits and Prohibitions Against Certain Contract Language

- **The new law allows Parties to contractually modify the Contractor's Design Responsibility and Risk, but within expressly stated limits.**

➢ **Limitation #1:** Contractors are prohibited from warranting design information they did not provide.

- "A contractor is not responsible for the consequences of design defects in and may not warranty the accuracy, adequacy, sufficiency, or suitability of plans, specifications, or other design documents provided to the contractor by a person other than the contractor's agents, contractors, fabricators, or suppliers, or its consultants, of any tier." *Tex. Bus. & Com. Code Ann. § 59.051*.
- However, Contractors are not prohibited from warranting the design it provides for a Design-Build project or as an EPC Contractor or a joint venture member of an EPC Contracting entity.

➢ **Limitation # 2:** Even if both Parties consent, § 59.051(a) mandates that a Contractor cannot waive Owner's responsibility for Owner-provided design defect.

III. Tex. Bus. & Com. Code § 59.051 – The New Texas Law (cont'd)

E. Enforcement Penalties

- **What is the penalty for a Contractor who fails to disclose design deficiencies it discovers in a "reasonable time" as required by law?**
  - "A contractor who fails to disclose a defect as required by Subsection (b) *may* be liable for the consequences of defects that result from the failure to disclose." *Tex. Bus. & Com. Code Ann. § 59.051(c).*

- **The legislature's use of the word MAY ("may be liable") is not clarified by any other section of the new law or its legislative history.**
  - The extent of liability resulting from a Contractor's failure to disclose design deficiencies it knew about or should have discovered using Ordinary Diligence is ambiguous and up for debate.
  - Direct damages only? Consequential damages?
  - Would the potentially open-ended liability language of § 59.051(c) supersede express contract language that might otherwise limit the contractor's liability (e.g., waiver of consequential damages)?

IV. Potential Issues in Texas after the New Law

- **As you can see, Texas' new law is not without ambiguity and potential issues which parties and counsel will debate and dispute over time.**
  - No reported decisions analyzing the new law at this time.

- **List of several issues will arise and require future resolution.**
  - What is the extent of the term “Critical Infrastructure Facility”?
  - What is / isn’t *necessary to the operation of* OR *directly related to* a Critical Infrastructure Facility?
  - Are there other Alternate Project Delivery Methods – other than express exemptions for Design-Build / EPC contracts – that may be exempt from the new law?
  - Are there ways Owners contract around the prohibition on waivers of the new law?
  - Can Owners contract around the prohibition on design warranty by Contractors?
  - What does “Ordinary Diligence” really mean and require for Contractor’s review of design documents?
  - What is a “reasonable time” for Contractors to report design defects?
  - If a Contractor fails to disclosure a defect it knew about or should have known about, what is the extent of its liability? Loss of a Contractor’s claim, sure, but how about liability for Owner damages? Damages to third parties?

IV. Potential Issues in Texas after the New Law (cont'd)

- **Critical Infrastructure Facility**
  - The new law does not define what makes a related facility "necessary to the operation of" and/or "directly related to" a Critical Infrastructure Facility.
    - E.g., the new law does not specifically include road transit projects in the definition of 'Critical Infrastructure Facility' so what about a highway or bridge project around a major city?
    - Must a project "necessary to the operation" of a Critical Infrastructure Project *be exclusively used for that project*?
  - Myriad examples of other projects can and will arise that may be arguably tied to Critical Infrastructure Projects.

- **Other Texas Statutes May Help Define "Critical Infrastructure Facility"**
  - Tex. Gov't Code § 423.0045(1-a) (military installations and detention facilities).
  - Tex. Penal Code § 30.05(7) (detention facilities must be completely enclosed by a fence or other physical barrier designed to exclude intruders).

IV. Potential Issues in Texas after the New Law (cont'd)

- **Broadened Definitions of Design-Build or EPC contracts that are Exempt from New Law?**
  - Design Build and EPC contracts are easy cases because such agreements provide the Contractor with full responsibility for the entire design.
  - What if a DB/EPC Contract is modified before or during performance such that the Owner imposes its own design on some aspect of the Contractor's work?
  - What about **delegated design** contracts? Can the new law apply to some parts of the work but not others?
  - What about IDIQ Contracts or Master Service contracts, where some work orders are design-build but other work orders are not?
- **Does the New Law Intend to Limit Exemptions to Only Design Build and EPC Contracts, or Does It (or Should It) Extend to Similar Hybrid Contracts?**
- **New law seems to incentivize Owners to utilize modern alternative project delivery methods (Design Build and EPC) in order to shift design risk on large and complex projects.**

IV. Potential Issues in Texas after the New Law (cont'd)

- **Hybrid Design Assist and Design Delegation Contracts:**
  - The new law does not apply to the portions of a contract where "the contractor agrees to provide input and guidance on plans, specifications or other design documents" but only to the extent that (i) such input is provided as signed and sealed work product of a licensed design professional; AND (ii) the work product is incorporated into the plans, specs or design docs used in construction. *§ 59.002(d).*
  - § 59.002(d) quoted above appears reasonably drafted, but what if the Contractor designed work scope often overlaps with the Owner designed scope? Where is the line to be drawn as to when § 59.002(d) applies and when it does not?

- **Performance vs. Design Specifications:**
  - Contract specifications are often a mixed bag of performance and design specifications. Does the new law apply to one portion that is a design specification, but not those portions that constitute a performance spec?
  - Case law implanting the *Spearin* doctrine routinely holds that it does not apply to performance specifications.

IV. Potential Issues in Texas after the New Law (cont'd)

- **Since waiver of the new law is not permitted by contract, parties should consider potential methods by which an Owner might attempt to achieve the same effect without specific waiver language?**
- **First,** parties should consider the effect of joint-venture entities where one JV party handles construction and the other handles design.

- **Second,** *§ 59.051(b)* defines the *Ordinary Diligence* with which a Contractor must review Owner-supplied design as the level of review used "in the reasonable preparation of a bid or fulfillment of its scope of work under normal circumstances" – but can parties agree that a given Project requires a contractor's review *beyond* normal circumstances?

QUESTIONS?

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