FORM FOLLIES
Void, Invalid, and Questionable AIA A201-1997 General Conditions Provisions Under Texas Law

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W. Kyle Gooch, Esq.
CANTERBURY, STUBER, ELDER, GOOCH & SURRATT, P.C.
5005 LBJ Freeway, Suite 1000
Dallas, Texas 75244

Matthew C. Ryan, Esq.
ROLLER AND ALLENSWORTH, L.L.P.
620 Congress Avenue, Suite 620
Austin, Texas 78701

The 1997 AIA A201 General Conditions document is a very useful "first step" in construction contract drafting. However, as many practitioners realize with respect to any form, it must be tailored for use in the particular jurisdiction in which the project is located and to reflect the needs of the parties. The following discussion is intended to help point out various portions of the AIA A201-1997 document that may need modification to comply with the requirements of the parties under Texas law.

Owner's Right to Carry Out the Work

Section 2.4.1 of AIA A201-1997 states, in part, as follows:

> "If the Contractor defaults or neglects to carry out the Work in accordance with the Contract Documents and fails within a seven-day period after receipt of written notice from the Owner to commence and continue correction of such default or neglect with diligence and promptness, the Owner may after such seven-day period, give the Contractor a second written notice to correct such deficiencies within a three-day period. If the Contractor, within such three-day period after receipt of such second notice, fails to commence and continue to correct any deficiencies, the Owner may, without prejudice to other remedies the Owner may have, correct such deficiencies.

The question that necessarily arises in this context is whether the Owner, by taking over the work within this cumulative ten-day period, is in danger of waiving certain rights to statutory relief. For example, § 27.004 of the Residential Construction Liability Act requires

a sixty-day notice from a claimant seeking damages from a Contractor pursuant to the Act. That section provides, in part:

> § 27.004. Notice and Offer of Settlement
> (a) Before the 60th day preceding the date a claimant seeking from a contractor damages arising from a construction defect files suit, the claimant shall give written notice by certified mail, return receipt requested, to the contractor, at the contractor's last known address, specifying in reasonable detail the construction defects that are the subject of the complaint."

Additionally, § 17.505 of the TEXAS DECEPTIVE TRADE PRACTICES ACT requires, as a prerequisite to filing suit, that notice be given to the prospective defendant at least sixty days before filing, advising of the consumer's specific complaints. That section provides, in part:

> § 17.505. Notice; Inspection
> (a) As a prerequisite to filing a suit seeking damages. . . against any person, a consumer shall give written notice to the person at least 60 days before filing the suit advising the person in reasonable detail of the consumer's specific complaint and the amount of economic damages, damages for mental anguish, and expenses, including attorneys' fees, if any, reasonably incurred by the consumer in asserting the claim against the defendant.

The specific language of the DTPA itself, specifically § 17.42, provides that a consumer's waiver of any of the Act's provisions violates public policy and is therefore void and unenforceable, unless that waiver is in writing and complies with the requirements provided in that same section.[1]

Warranty

Section 3.5.1 of AIA A201-1997 provides for a warranty that carries no specified time limit. That section reads as follows:

> "3.5.1 The Contractor warrants to the Owner and Architect that materials and equipment furnished under the Contract will be of good quality and new unless otherwise required or permitted by the Contract Documents, that the work will be

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1 **For a discussion of DTPA § 17.42's effect, *see, e.g., Arthur's Garage, Inc. v. Racal-Chubb Security Systems, Inc.,* 997 S.W.2d 803, 811 (Tex. App. - Dallas 1999); *Southwestern Bell Telephone Co. v. FDP Corp.*, 811 S.W.2d 572, 576 (Tex. 1991) (both cases holding that limitation of liability clauses in the subject contracts were ineffective).**

> free from defects not inherent in the quality required or permitted, and that the Work will conform to the requirements of the Contract Documents. Work not conforming to these requirements, including substitutions not properly approved and authorized, may be considered defective. The Contractor's warranty excludes remedy for damage or defect caused by abuse, modifications not executed by the Contractor, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage. If required by the Architect, the Contractor shall furnish satisfactory evidence as to the kind and quality of materials and equipment."

In contrast, Texas' CIVIL PRACTICE & REMEDIES CODE §§ 16.004 and 16.051 both provide for a four-year statute of limitations for breach of contract claims, and §§ 16.008-16.009 provide for an overall ten-year statute of repose. (See also the discussion of accrual and tolling of the statute of limitations on warranty claims below.)

Indemnity

In §§ 3.18.1 through 3.18.3 of AIA A201-1997, the Contractor agrees to indemnify the Owner and Architect as follows:

> ". . . Contractor shall indemnify and hold harmless the Owner, Architect . . . arising from and against claims, damages . . . arising out of or resulting from performance of the work. . . but only to the extent caused by the negligent acts or omissions of the Contractor . . . "

This language fails to satisfy the "express negligence" and "clear and conspicuous" tests necessary under Texas case law to provide for another's future negligence.[2] If the Owner (the Indemnitee) desires to obligate the Contractor (the Indemnitor) to indemnify the Owner for its negligence, the paragraph must be reworded and must be underlined or otherwise made conspicuous to be enforceable.

Additionally, Texas' CIVIL PRACTICE & REMEDIES CODE § 130.002 prohibits a contractor from assuming liability for an architect's negligence that is associated with the preparation of plans and specifications.[3] However, based on the present wording of the section, the Contractor is only liable for its own negligence.

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***See Ethyl Corporation v. Daniel Construction Company*, 725 S.Wd2d 705 (Tex. 1987); *see also Dresser Industries, Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993).**

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An additional indemnity-related matter encountered in the language of A201-1997 can be found at § 10.3.3, dealing with hazardous materials encountered at (but not brought to) the jobsite. While the sole negligence of an indemnified party is excluded from the scope of indemnity imposed, this language still fails to meet the conspicuousness requirements of *Ethyl* and *Dresser*.

Time Limits on Claims

Section 4.3.2 of AIA A201-1997 states as follows:

> "Claims by either party must be initiated within 21 days after occurrence of the event giving rise to such claim or within 21 days after the claimant first recognizes the condition giving rise to the Claim, whichever is later. . . ."

This language appears to state that a claim will be waived if notice is not provided in a timely fashion. Texas law, however, contains a number of statutory provisions in which a longer period is mandated. Examples include the Deceptive Trade Practices Act, as well as § 27.004 of the Residential Construction Liability Act (RCLA), as described in greater detail above, where waiver of these rights is not allowed in most circumstances.

Additionally, § 16.071 of the TEXAS CIVIL PRACTICE & REMEDIES CODE states, in part, as follows:

> "A contract stipulation that requires a claimant to give notice of a claim for damages as a condition precedent to the right to sue on the contract is not valid unless the stipulation is reasonable. A stipulation that requires notification within less than 90 days is void."

In the Texas Supreme Court case of *American Airlines Employees Federal Credit Union v. Martin*, 29 S.W. 3d 86, 43 Tex. Sup. Ct. J. 1196, (Tex. 2000), the Court construed a provision in a deposit agreement with respect to a depositor and his credit union. The depositor was required to notify the credit union within 60 days of payment of any unauthorized items in order to prevent further unauthorized transactions. An argument was made that this provision violated § 16.071 of the TEXAS CIVIL PRACTICE & REMEDIES CODE. However, the Court stated that the Code section did not apply because the notice required to be given was not a notice of a claim for damages but rather a notice of unauthorized transactions.

Similarly, in the case of *Komatsu v. United States Fire Insurance*, 806 S.W.2d 603 (Tex. App. – Fort Worth 1991), a legal malpractice policy required an attorney to give notice of a claim to his carrier within his policy period. The argument was likewise made that this

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***See Foster, Henry, Henry & Thorpe, Inc. v. J.T. Construction Company, Inc.*, 808 S.W.2d 139 (Tex. App. - El Paso 1991, *writ den'd*).**

provision violated § 16.071 of the TEXAS CIVIL PRACTICE & REMEDIES CODE. The Court held, however, that notice of a claim made was not the same as a claim for damages against the carrier. It is unclear—and the authors have found no cases on point—as to whether or not the AIA notice provisions would be void under § 16.071 of the TEXAS CIVIL PRACTICE & REMEDIES CODE to the extent they require notification of a claim for damages within less than 90 days.

Waiver of Consequential Damages

Section 4.3.10 of AIA A201-1997 A201states as follows:

> The Contractor and Owner waive all claims against each other for all consequential damages arising out of or relating to this Contract. This mutual waiver includes
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> 1. Damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation and for loss of management or employee productivity or of the services of such persons; and
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> 2. Damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit other than anticipated profits arising directly from the work.
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> This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination in accordance with Article 14. Nothing contained in this subparagraph 4.3.10 shall be deemed to preclude an award of liquidated direct damages, when applicable, in accordance with the requirements of the Contract Documents.

This clause reserves the right of the parties to negotiate for liquidated damages based on delay in the Contractor's performance. A liquidated damage provision is enforceable only if the amount is a reasonable proximation of the probable loss that will be caused by delayed performance and if the damage caused by the delay is difficult or impossible to determine.[4]

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[4] ***Stewart v. Basey*, 245 S.W.2d 44 (Tex. 1952); *also note Loggins Constr. Co. v. Stephen F. Austin State University*, 543 S.W.2d 682 (Tex.Civ.App.--Tyler 1976, writ ref'd n.r.e.).**

In addition to the possibility of an unenforceable liquidated damages provision, the last sentence of this AIA clause may create some difficulty in enforceability to the extent it could be held to be a voidable limitation of liability clause. In the case of *Valero Energy Corp. v. M. W. Kellogg Construction*, 866 S.W.2d 252 (Tex. App.—Corpus Christi 1993, *writ den'd*), the court upheld the enforceability of a limitation of liability clause and noted that the parties were sophisticated entities, were represented by learned counsel, and both parties were familiar with the particular industry involved.

Attorney's Fees

AIA A201-1997 contains no provision for the awarding of attorney's fees to a prevailing party, whereas the TEXAS CIVIL PRACTICE & REMEDIES CODE § 38.001 states that:

> A person may recover reasonable attorney's fees from an individual or corporation, in addition to the amount of a valid claim and costs, if the claim is for:
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> rendered services;
> performed labor;
> furnished material;
> . . .
> a sworn account; or
> an oral or written contract.[5]

[5] **But see *Green International, Inc. v. Solis,* 951 S.W.2d 384, 390 (Tex. 1997), where the Court observed that, in order to recover attorney's fees under § 38.001, a party must "(1) prevail on a cause of action for which attorney's fees are recoverable, and (2) recover damages."**

In the context of an arbitration (called for by AIA A201-1997 and therefore available at the election of either or both parties), where the arbitrators are not bound to follow the law that would be applicable to that case in court,[6] the outcome of a claim for attorney's fees by a prevailing party is by no means a certainty.[7] Parties desiring to recover attorneys' fees, in defense, obviously need to modify the AIA A201-1997 form to allow for attorneys' fees to be awarded to the prevailing party, if it is the intent of the parties to do so.

Architect's Withholding of Payment

Section 9.5.1 of AIA A201-1997 empowers the Architect to withhold funds for a variety of reasons, most of which are geared toward protection of the Owner. Irrespective of the Architect's reasons for withholding payment, an erroneous decision by the Architect on this front could place the Owner in danger of violating Texas' Prompt Pay Statute, Chapter 28 of the TEXAS PROPERTY CODE. Given the fact that Texas' prompt pay penalties carry an interest rate of 1.5% per month, this is not an issue to be taken lightly. Additionally, 31 U.S.C.A. §§ 3902(a) and 3905, the "Prompt Payment" provisions applying to certain federal construction projects and amounts disbursed therefor, represent a potential source of loss for the Owner if payments are unjustly withheld from contractors, subcontractors, or suppliers.

Additionally, the Texas Trust Fund Statute, Chapter 162 of the TEXAS PROPERTY CODE, states that funds are trust funds if borrowed by an Owner for use on a construction project. The wrongful retention of trust funds by a withholding architect could subject an Owner to liability under the Act. While there are "good faith" defenses and other affirmative defenses to the statutes, it should be remembered that various code provisions increase the risk of a wrongful decision to withhold.

Trust Funds

Section 9.6.7 of AIA A201-1997 states, in part, as follows:

> "Unless the Contractor provides the Owner with a payment bond in the full penal sum of the Contract sum, payments received by the Contractor for work properly performed by

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[6] ***See, e.g., Jamison & Harris v. Nat'l Loan Investors*, 939 S.W.2d 735 (Tex.App.—Houston [14th Dist.] 1997) (no writ); *J.J. Gregory Gourmet Services v. Antone's Import Co.*, 927 S.W.2d 31 (Tex.App.—Houston [14th Dist.] 1995) (no writ).**

[7] **The Federal Arbitration Act, while not providing for attorneys' fees for a party that successfully confirms an arbitration result in federal court (*see Menke v. Monchecourt*, 17 F.3d 1007, 1009 (7th Cir. 1994)), does provide for the recovery of attorneys' fees if the party challenging the award does so for reasons that are "without merit," "without justification," harassing, in bad faith, or legally frivolous. *See In re: Arbitration Between Trans Chemical Ltd. and China Nat'l Machinery Import and Export Corp.*, 978 F.Supp. 266, 311 (S.D.Tex. 1997) (*citing Executone Information Systems, Inc. v. Davis*, 26 F.3d 1314, 1331 (5th Cir. 1994).**

> Subcontractors and Suppliers shall be held by the Contractor for those Subcontractors or Suppliers who performed work or furnished materials, or both, under contract with the Contractor for which payment was made by the Owner. Nothing contained herein shall require money to be placed in a separate account and not commingled with money of the Contractor, shall create any fiduciary duty or tort liability on the part of the Contractor for breach of trust or shall entitle any person or entity to an award of punitive damages against the Contractor for breach of the requirements of this provision.

The Texas Trust Fund Statute establishes that a contractor or subcontractor who receives construction project funds is a trustee of the funds on behalf of those downstream who have provided materials and/or labor to the project. Also liable under this law are owners who take out loans for property improvement (where there is a lien), as well as individuals who have control or exercise direction over the funds. The statute, however, provides an affirmative defense for situations where monies are used to pay actual expenses directly related to the construction and where a "reasonable" dispute is involved with the amounts claimed/owed. Nonetheless, as a result of amendments to the statute made in 1987, the withholding party bears the burden of showing that the expenses were, in fact, related to construction or repair. Possibly included among the array of penalties is prosecution for misapplication of fiduciary property, as specified in Texas Penal Code § 32.45.

In the case of *Fisk Allied v. Manhattan Construction*, 835 F. Supp. 334 (E.D.Tex. 1993), the Court noted that the Texas Trust Fund Statute did not create a classic trust and therefore the subcontractor could not use the Texas Trust Fund Statute to obtain a prejudgment injunction to freeze money held by the general contractor which it had received from the Owner for the claim. This AIA provision appears to disclaim such liability yet places an affirmative duty upon the Contractor. This provision could be interpreted to expand the duties that a Contractor may have under the Texas Trust Fund Statute.

Usury

Section 13.6.1 of AIA A201-1997 states as follows:

> "Payments due and unpaid under the Contract document shall bear interest from the date payment is due at such rate as the parties may agree upon in writing or in the absence thereof at the legal rate prevailing from time to time at the place where the Project is located."

Section 302.002 of the TEXAS FINANCE CODE states that if the parties do not agree upon an interest, interest at the rate of 6% may be charged 30 days after the date on which the amount is due. In the case of *Commerce, Crowdus, and Canton v. DKS Construction, Inc.*, 776 S.W.2d 615 (Tex. App. – Dallas 1989), the parties used a similar AIA contractual provision

and had not agreed upon a specific interest rate. The Court held that any charging within the first 30 day "interest-free" period constituted a "double charging" of interest prohibited by the Texas usury statutes. At the time this opinion was written, the penalty involved the forfeiture of all principal on which the interest had been charged.

The TEXAS FINANCE CODE now provides in § 305.002 that if one charges interest that is greater than the amount authorized that creditor is liable for the greater of (1) three times the amount of excessive interest, or (2) $2,000 or 20% of the amount of the principal, whichever is less. If interest has actually been received, § 305.002 allows for the forfeiture of all principal if the interest charge is greater than twice the amount authorized. The TEXAS FINANCE CODE further provides that a charging within the "interest-free" period is no longer a double charging as a matter of law.

Payment of Retainage

Section 9.8.5 of AIA A201-1997 states as follows:

> The Certificate of Substantial Completion shall be submitted to the Owner and Contractor for their written acceptance of responsibilities assigned to them in such Certificate. Upon such acceptance and consent of surety, if any, the Owner shall make payment of retainage applying to such work or designated portion thereof. Such payment shall be adjusted for work that is incomplete or not in accordance with the requirements of the Contract Documents.

This language presents a problem when contrasted with statutorily imposed duties placed on Texas project owners to withhold ten percent of construction funds as retainage, and to withhold trapped funds, on private non-bonded projects for the periods of time set forth in the TEXAS PROPERTY CODE. See §§ 53.081-53.084, as well as § 53.101.

The Discovery Rule and Accrual of a Cause of Action

Section 13.7.1 of AIA A201-1997 provides, in a section entitled Commencement of Statutory Limitation Period, as follows:

As between Owner and Contractor:

> Before Substantial Completion. As to acts or failures to act occurring prior to the relevant date of Substantial Completion, any applicable statute of limitations shall commence to run and any alleged cause of action shall be deemed to have accrued in any and all events not later than such date of Substantial Completion.

In Texas, the general rule is that a cause of action accrues "as soon as the defendant's wrongful act effects some injury,"[8] and this has been held to apply to actions based on negligent design and construction of an improvement to real property.[9] As we all know, the "discovery rule" will toll the running of the statute of limitations in certain cases, such as legal malpractice.[10] Such grounds for halting the clock on the statute are limited, however, and Texas courts have generally observed that the discovery rule is very much an exception to the general rule.[11]

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[8] ***See Trinity River Authority v. URS Consultants, Inc.*, 889 S.W.2d 259, 262 (Tex. 1994) (*citing Murray v. San Jacinto Agency, Inc.*, 800 S.W.2d 826, 828 (Tex. 1990)).**

[9] ***See id.***

[10] ***See Willis v. Maverick*, 760 S.W.2d 642, 646 (Tex. 1988).**

[11] ***See Trinity River*, *supra*, 889 S.W.2d at 262 (*citing Moreno v. Sterling Drug, Inc.*, 787 S.W.2d 348, 351 (Tex. 1990)).**

The above-cited *Trinity River* case observed directly that Texas courts had "not previously [adopted the discovery rule] for actions based on negligent design or construction of an improvement to real property."[12] It breathed new life into a case from 1888 where a suit was time-barred despite the fact that the defendant installed a concealed arch in a building that later caused the entire building to settle and crack.[13] *Trinity River* featured the adjudication of a constitutional open courts challenge to the statute of repose in TEXAS CIVIL PRACTICE & REMEDIES CODE § 16.008, and the court was therefore liberated to narrow the scope of its decision, steadfastly refusing to state whether it would adopt the discovery rule if confronted with the facts of that particular case. A reading of the opinion, however, suggests that the court might well have adopted the discovery rule if this had been necessary.

This field remains a complicated one in Texas, but the handwriting may well be on the wall in the form of the *Trinity River* "hint" and earlier Texas cases. The Corpus Christi Court of Appeals, in a 1993 case,[14] adopted the discovery rule in a suit for negligent design and construction. In *Dallas Market Center*, leaks appeared in a building immediately after completion of the project, and a series of repair efforts were undertaken to remedy apparent masonry defects. Six years after the project's completion, the owner enlisted an engineer to undertake a comprehensive analysis of the building, and suit was filed soon thereafter. Despite the passage of time, the court stated that the owner's cause of action accrued when it knew—*or when a reasonable person should have known*—of the facts giving rise to the cause of action. A dismissal of the case on limitations grounds was denied, with the court holding that there was a fact issue as to whether the statute should have commenced during the initial repair efforts or once a design professional was hired to evaluate the structure. A writ of error was denied in this case.

A still earlier case involved a homebuilding contractor who was held liable nine years after it conveyed the home and surrounding land to the buyer, this on a theory of implied warranty of the home's fitness and habitability.[15] The court in *Richman* allowed a tolling of the statute until the home buyer discovered or should have realized the existence of the problem, which in this case was only when a visible defect had manifested itself. Other reported cases exist that feature delayed accrual for latent construction defects for breach of warranty.[16]

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12 ***See Trinity River*, 889 S.W.2d at 262.**

13 ***See Houston Water-Works Co. v. Kennedy*, 70 Tex. 233, 8 S.W. 36 (1888).**

14 ***Dallas Market Center Hotel Co. v. Beran & Shelmire*, 865 S.W.2d 145 (Tex.App.—Corpus Christi 1993, writ den'd).**

15 ***Richman v. Watel*, 565 S.W.2d 101 (Tex.Civ.App.—Waco 1978), *affirmed*, 576 S.W.2d 779 (Tex. 1978).**

16 ***See, e.g., Vaughn Building Corp. v. Austin Co.*, 620 S.W.2d 678 (Tex.Civ.App.—Dallas 1981), *affirmed*, 643 S.W.2d 113 (Tex. 1982).**

A 1994 appellate decision out of Houston, however, demonstrates that this area of the law remains a mixed bag. In *Bayou Bend Towers Council of Co-Owners v. Manhattan Construction Co.*,[17] the plaintiff sought to recover on an implied warranty claim against the design and construction entities on a project. The Court in *Bayou Bend* referenced the Deceptive Trade Practices Act, which by its own terms expressly adopts the discovery rule, and adopted the legal injury rule, holding that accrual occurred at the same time as when the damage first occurred.

[17] **866 S.W.2d 740 (Tex.App.—Houston [1st Dist.] 1994, writ den'd).**

As an additional matter, §§ 4.4.5 and 4.4.6 of AIA A201-1997 state that the Architect will rule on claims by written decision, and that – if the Architect so states in his decision – the losing party has thirty days to file for mediation or arbitration. If this purports to bar claims not made within this period, these terms may run afoul of TEXAS CIVIL PRACTICE & REMEDIES CODE § 16.070, which states that parties cannot contract for a limitations period that is shorter than two years.[18]

Conclusion

Naturally, if a construction attorney creates a checklist—informed and buttressed by past readings and direct experience—when proceeding through contract negotiations and marking up successive versions of a document, chances are fair that the client will find itself to have been well served if and when a dispute arises. Reasonable parties to the drafting process should be able to agree on equitable, non-overreaching modifications to some of the AIA A201-1997 provisions that, if left unaltered, could run up fees simply through the process of disputing their viability.

Regardless of the comments with respect to the AIA A201-1997's provisions above, contract drafters and negotiators should take notice of § 13.4.1, which states, "Duties and obligations imposed by the Contract Documents and rights and remedies available thereunder shall be in addition to and not a limitation of duties, obligations, rights and remedies otherwise imposed or available by law."

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Note the case of *Jett v. Truck Ins. Exchange*, 952 S.W.2d 108 (Tex.Ct.App.—Texarkana 1997) in which insurance provisions limiting time in which to file suit two years and a day were valid and binding.