

Presented:

2012 Construction Law Conference

September 13 – 14, 2012
Belo Mansion, Dallas, TX**TOP CONSTRUCTION CONTRACT ISSUES
AND PRESSURE POINTS FOR THE PLAYERS**
*The Owner's Perspective***Leslie C. Thorne**
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Top Construction Contract Issues and Pressure Points for the Players

The Owner's Perspective

When owners embark on a construction project, they naturally put significant energy into determining the project's value. But that expected value can be completely wiped away if the owner fails to understand key provisions and adequately control its risk. Generally speaking, owners hold the most power when negotiating with other players, including the general contractor. They should wield that power to ensure minimum risk without unduly increasing construction costs.

The owner's first line of defense in reducing risk is its contract with the general contractor. Some owners do not effectively protect themselves, instead relying on "industry standard forms." But, even when the owner uses a form contract, it should carefully examine every provision and make modifications, as appropriate, to best protect itself. Among the myriad provisions of which owners should be aware, some create headaches again and again. Owners should therefore pay particularly close attention to those provisions concerning or involving (1) flow-through rights and obligations, (2) site and local conditions, (3) delay damages, (4) warranties and correction periods, and (5) conditions precedent.

A. THE STANDARD FORMS

American Institute of Architects (the "AIA") form contracts have historically been the industry standard. While some contractors and subcontractors prefer the ConsensusDOCS form, AIA's A201 form continues to be the industry norm. As such, when discussing standard provisions, this paper will focus on the AIA form.

Whatever form is chosen, owners must modify the standard provisions to their own needs and desires. Many provisions favor the general contractor and any provision can be negotiated. Moreover, owners should remember that these are national forms and may not adequately address (or conform to) issues raised in Texas cases or statutes.

B. FLOW-THROUGH AND ASSIGNMENT PROVISIONS

1. Don't Flow-Through Provisions Only Affect Contractors and Subcontractors?

Flow-through (or flow-down) clauses typically refer to provisions that transfer responsibility or obligations from the general contractor to the subcontractor, or incorporate the prime contract's provisions into the various subcontracts. While disputes and issues related to these provisions most often arise between contractors and subcontractors, owners can be impacted as well. Moreover, owners may have their own "flow-through" issues to contend with when it comes to lending documents.

2. Dispute Resolution Provisions: Are The Subcontractors Bound By The General Contract's Provisions?

One area in which flow-through provisions may become relevant to the owner is dispute resolution. Owners' claims—especially construction defect claims—usually involve multiple

players. Most typically, the owner will sue the contractor, who will then point the finger at one or more subcontractors or suppliers. The design professionals also may become involved. Generally, it makes sense for all potential parties to be joined in a single action.

A201 §§ 15.3 and 15.4 concern dispute resolution procedures for claims between the owner and general contractor. But are subcontractors bound by these provisions? For instance, if the owner makes an arbitration demand against the general contractor, can the general contractor bring in subcontractors?

Probably yes. Joinder of third parties—including subcontractors—is fairly straightforward when the dispute is handled in court. Arbitration proceedings, on the other hand, are generally limited to those who have actually agreed to arbitrate. *In re Merrill Lynch Trust Co.*, 235 S.W.3d 185,192 (Tex. 2007). But, in the event the owner and contractor elect to include an arbitration provision in the contract, A201 § 15.4.4 provides that third parties may be joined as long as their presence is required to afford “complete relief” in the arbitration.¹ If the subcontracts at issue incorporate the main contract through a flow-through provision, joining the subcontractors to an owner-general contractor dispute should be permitted. Joining design professionals may be another matter. Given that their agreements typically do not incorporate the general contract, the owner may encounter difficulty joining them to arbitration absent a separate arbitration provision (including consolidation and joinder provisions) in the design agreements themselves.

3. Lender-Related Provisions

Like provisions addressing the owner’s and subcontractors’ rights and obligations in the face of a general contractor’s default, many contracts also include provisions related to the lender’s role in the event of an owner default. Specifically, under A201 § 13.2.2, the owner may “assign the Contract to a lender providing construction financing for the Project, if the lender assumes the Owner’s rights and obligations under the Contract Documents. The Contractor shall execute all consents reasonably required to facilitate such assignment.” This serves as an exception to the general requirement that neither the owner nor the general contractor may assign the contract without the other’s written consent.

For owners financing their projects, this provision can be critical because most lenders will require an assignment as the financing’s security. Financing documents also may include additional requirements related to the general contractor’s performance, so owners should make sure to read and understand any other lender requirements and ensure compliance in the general contract. In order to maintain financial flexibility over the course of a project, owners also may want to expand the language of § 13.2.2 to include an automatic right to assign the contract to qualified (i.e., financially capable) third parties.

C. DIFFERING SITE AND LOCAL CONDITIONS

After plans and specifications have been issued, and the construction contract executed, the parties may discover unforeseen site or local conditions. These may include subsurface or latent conditions differing from those identified in the plans, or unusual physical conditions that differ

¹ Owners should think critically about whether they truly want to include an arbitration provision. While well-funded, sophisticated parties historically favored arbitration agreements, the current trend is away from arbitration.

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First appeared as part of the conference materials for the
2012 Construction Law session

"Top Construction Contract Issues and Pressure Points for the Players"