# DRAFTING THE CONTRACT
# WITH AN EYE TOWARD LITIGATION

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Note, *Jeanes v. Henderson: The Res Judicata Effect of Prior Federal Judgments on Omitted Pendent State Related Claims*, 23 HOUS. L. REV. 1295 (1986)

MAJOR LITIGATION:

*Pearson v. Callahan*, 555 U.S. 223 (2009) (overruling Saucier v. Katz and holding that the two-step qualified immunity inquiry can occur in any order) (representing Texas Association of School Boards as friend of the court).

*City of Austin v. Whittington*, No. 10-0361 (Tex.) (pet. granted, Apr. 15, 2011) (to address role of jury, if any, and separation of powers implications in determining affirmative defenses to the exercise of eminent domain, defenses such as arbitrariness, fraud, and bad faith) (representing Clear Lake City Water Authority as friend of the court).

*City of Waco v. Kirwan*, 298 S.W.3d 618 (Tex. 2009) (holding that cities owe no duty under the Recreational Use Statute to warn of naturally occurring dangers in city parks) (representing Texas Municipal League as friend of the court).

*City of Galveston v. State*, 217 S.W.3d 466 (Tex. 2007) (case of first impression establishing the immunity of Texas local governmental entities from suit by the State of Texas).

*Montgomery County v. Park*, 246 S.W.3d 610 (Tex 2007) (adopting modified *Burlington* standard defining "adverse personnel action" in Texas Whistleblower Act cases) (representing Texas Association of School Boards as friend of the court).

*City of Oak Ridge North v. Mendes*, 339 S.W.3d 222 (Tex. App.—Beaumont 2011, no pet.) (holding that governmental immunity bars claims for violation of the Texas Wiretap Statute, Tex. Civ. Prac. & Rem. Code Chap. 123).

*Cypress Forest Pub. Util. Dist. v. Kleinwood Mun. Util. Dist.*, 309 S.W.3d 667 (Tex. App.—Houston [14th Dist.] 2010, no pet.) (holding in inverse condemnation context that contract rights are not "property" within the meaning Art. I, Sec. 17 of the Texas Constitution).

*Clear Lake City Water Auth. v. Salazar*, 781 S.W.2d 347 (Tex. App.–Houston [14th Dist.] 1989, orig. proceeding [leave denied]) (recognizing for the first time in Texas law a local legislator's constitutional privilege to resist judicial intrusion into legislative motives).

*Colson v. Grohman*, 174 F.3d 498 (5th Cir. 1999) (holding that the First Amendment does not protect a politician from politically-motivated defamation).

*City of Galveston v. Gray*, 93 S.W.3d 287 (Tex. App.–Houston [14th Dist.] 2002, pet. denied) (case of first impression recognizing that governmental immunity from suit includes immunity from discovery).

*Gaines v. Davis*, 928 F.2d 705 (5th Cir. 1991) (recognizes the right of an official to pursue an interlocutory appeal of a discovery order that violates the doctrine of qualified immunity from suit).

*City of Fort Worth v. Zimlich*, 99 S.W.3d 62 (Tex. 2000) (establishing legal standard for imputing discriminatory intent to a governmental entity under the Texas Whistleblower Act) (representing Texas Association of School Boards as friend of the court).

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# DRAFTING THE CONTRACT WITH AN EYE TOWARD LITIGATION

## I. INTRODUCTION.

Generally, when a governmental entity enters a contract, it waives its immunity from liability and becomes liable on the contract as if it were a private party. Thus, to the extent this general rule applies, a course on tips for how to draft a government contract is no different than a course on tips for contract drafting generally.

This Paper is not a primer on how to draft a contract. The focus here is on how best, when drafting contracts for a governmental client, to take advantage of the single major exception to this general rule that contact law applies to government and private parties alike. The exception is that government must act along formal lines of authority, and thus, as Justice Holmes famously put it, "men must turn square corners when they deal with the Government."[1] The thesis of this Paper is that the contract should be drafted to keep the lines of authority crisp and protect the public fisc from claims for contractual extras and increases that were never properly authorized.

## II. AUTHORIZATIONS.

In public contracting, governmental entities are bound only by the actual authority they confer on their officers and employees, and the doctrine of apparent authority is inapplicable. The requirement of actual authority in public contracting serves to protect the public treasury against unauthorized commitments and loss of control over public expenditures. *See* Whelan & Dunigan, *Government Contracts: Apparent Authority and Estoppel*, 55 GEO. L.J. 830, 833 (1967) ("The concern is that the resources of the Treasury, created from the tax contributions of the entire citizenry, should not suffer from the shrewd efforts of citizen-contractors or from the indifference of government agents. An effort is made to guard against this possibility by defining functions and duties; in other words, by structuring and limiting authority.").

Texas, like most other jurisdictions, follows the rule that "a city or county may contract only on express authorization by vote of the governing body reflected in the minutes." *Southern Disposal, Inc. v. City of Blossom*, 165 S.W.3d 887, 893 (Tex. App.—Texarkana 2005, no pet.) (following *City of Bonham v. Southwest Sanitation, Inc*., 871 S.W.2d 765, 767 (Tex. App.—Texarkana 1994, writ denied)). Although cities may delegate to others the right to perform acts and duties necessary to the transaction of the city's business, they can do so only by resolution or ordinance, by a majority vote. *City of San Benito v. Rio Grande Valley Gas Co.*, 109 S.W.3d 750, 757 (Tex. 2003).[2]

In many contracts, the governing body will delegate power to other officials or professionals such as engineers to administer the performance of the contract, while retaining power for itself to approve material changes to the contract. Contracts should expressly create a process for confirming the actual authority of designated owner representatives for the purpose of minimizing the confusion over the extent of actual authority. Requirements that confirm actual authority operate as a "shield" for the owner against unauthorized contractor claims. Care must be taken to ensure that terms delegating contracting authority are clear and not overly inclusive. *See Diamond B Constr. Co. v. City of Plaquemine*, 673 So. 2d 638 (La. App. 1996) (because contract defined "owner" to include engineer, engineer's determination that work was substantially complete bound city to make payment, even though work was incomplete). The contract should identify by name or position all such persons whose acts (or acquiescence) may be deemed sufficient to bind the entity with respect to certain activities, as well as delineate the scope of authority that each such person has been given.

In many form construction contracts, the broad definition of the term "Owner" creates openings for contractors to raise fact issues concerning lines of authority. Consider the following definitions of "Owner" and "Resident Project Representative" from the EJCDC C-700 Standard General Conditions. (The bracketed language is a suggested clarification.)

> *Owner* – The individual or entity with whom the Contractor has entered into the Agreement and for whom the Work is to be performed. *[Wherever in this Agreement it is contemplated that an act is to be taken by "Owner," such act must occur in the form of*

[1] *See Rock Island, Ark. and La. R.R. v. United States*, 254 U.S. 141, 143, 65 L. Ed. 188, 41 S. Ct. 55 (1920) (Holmes, J.).

[2] *See also* 10 E. McQuillin, MUNICIPAL CORPORATIONS § 29.15, p. 315 (3d Ed. Rev. 1990) ("The officer, body or board duly authorized must act [on] behalf of the municipality, otherwise a valid contract cannot be created. Generally the power to make contracts on behalf of the municipality rests in the council or governing body . . . . Generally, no officer or board, other than the common council, has power to bind the municipal corporation by contract, unless duly empowered by statute, the charter, or authority conferred by the common council, where the latter may so delegate its powers . . . .").

*a formal vote taken by Owner's governing body in a public meeting. Otherwise, the act is invalid and not binding.]*

*Resident Project Representative* – The authorized representative of Owner who may be assigned to the Site or any part thereof. *[The authorized representative of Owner is _____ and no other person.]*

To the extent that the governing body intends to retain control over such decisions as approval of change work orders, contract extras, modifications of any contract terms, and the like, that intent should be clearly expressed in the contract. In some types of contracts, it is common to see delegations of spending authority within specific dollar limits, while reserving the governing body's power to approve any changes beyond that dollar limit. Consider the following delegation to approve minor change orders:

> The City Council has delegated to Project Manager the power to approve, without prior authorization of the Council, the issuance of Change Orders or Extra Work Orders, pursuant to this Agreement, in a cumulative amount not exceeding 10% or $50,000.00 above the initial contract price of said agreement, whichever is greater; provided that if the issuance of any such Change Order or Extra Work Request would result in exceeding said 10% or $50,000.00 limitation, or if the issuance of any one such Change Order or Extra Work Order would require an expenditure by the City of an amount exceeding $50,000.00, it shall not be issued and will not be valid or enforceable without prior authorization of the City Council.[3]

## III. PRICING.

Because of competitive bidding laws, public contracts are usually bid on either a fixed price or a fixed unit price basis.[4] A fixed price contract is often preferred by government because it places upon the contractor the maximum risk and full responsibility for all costs and resulting profits or loss, and thus provides a maximum incentive for the contractor to control costs and perform effectively. *See generally*, 1 Philip L. Bruner & Patrick J. O'Connor, Jr., BRUNER & O'CONNOR ON CONSTRUCTION LAW § 2:16, p. 74 (West 2009) [hereinafter cited as BRUNER & O'CONNOR]. Unit price contracts utilize fixed-unit prices to pay for completed work items which, at the time of bidding, could only be estimated as quantities due to the impracticability of determining actual quantities before performing the work. *Id*. at § 2:17, p. 74.

Unit price contracts typically are used to price work involving estimated quantities of earth excavation, pipeline installation, site de-watering, removal of unsuitable materials, replacement with engineered fill, and similar conditions for which bidders, in the absence of unit pricing, would be obliged to build pricing contingencies into their bids to cover possible variations in quantities. Fixed-unit prices generally include all work "incidental" to performance of the unit-priced item of work. Therefore, each unit-priced item of work must be carefully defined. In a unit price contract, disputes can also arise over methodologies used to measure units. Thus, the contract should clearly spell out how the measurement will be conducted and by whom.

Most public contracts recite a "total price" or "contract sum," and governmental entities appropriate funds to pay that price as part of the process of approving the contract. These total price terms, however, may conflict with unit pricing, which in theory is open-ended. In unit-priced contracts, the contract "sum" is often calculated on the basis of a liberal estimate of the units of work to be performed. For example, a contract approved by a governing body might provide for a project to be completed "for the sum of" $3,000,000.00. The bid proposal, incorporated by the written contract, will also provide: "Contractor certifies to the following Work for the following bid item unit prices, bid associated extended totals and sum of extended totals as listed on the following unit price bid schedule: [listing unit price of,

[3] Adapted from delegation clause recited in *Massachusetts Bay Transp. Auth. v. H.W. Moore Assocs*., 1995 Mass. Super. LEXIS 617 (Mass. Super. Ct. Feb. 14, 1995). This practice is authorized by Texas law. See, e.g., TEX. LOC. GOV'T CODE 262.031(b) ("If a change order involves an increase or decrease in cost of $50,000 or less, the commissioners court may grant general authority to an employee to approve the change orders.").

[4] This is the rule by statute for counties. *See* TEX. LOC. GOV'T CODE § 262.028 ("Sec. 262.028 ("A purchase may be proposed on a lump-sum or unit price basis. If the county chooses to use unit pricing in its notice, the information furnished bidders must specify the approximate quantities estimated on the best available information, but the compensation paid the bidder must be based on the actual quantities purchased.").

say, $1,000 per unit]." The $3,000,000 contract "sum" price derives from a liberal estimate of the quantity of units of work to be performed (3000 units) times the $1,000 unit price. Unit price contracts, however, provide for payment on the basis of *actual* quantities performed, not the quantities *estimated* for purposes of the bidding purposes. Therefore, if in this hypothetical the contractor actually performs 4000 units of work, a dispute may arise over whether the contract "sum" should operate as a $3 million ceiling, or whether the contractor is owed $4 million out of current revenues for the number of units of work actually performed.

Draftsmen of unit-priced contracts should thus anticipate this potential conflict by clarifying whether the contract "total" or "sum" price is intended to operate as a ceiling. For example, a provision to establish a ceiling price might read as follows:

> "This is an indefinite quantity contract with fixed unit pricing and a maximum contract ceiling price, with payments based on the documented delivery of the specified units of service. The Sum Price of $3,000,000.00 is the contract ceiling price and controls over unit prices to the extent aggregate unit prices exceed the Sum Price."

If a ceiling price is intended, it should be subject to change only upon a written change order of the governing body. For example:

> If the Contractor wishes to make a claim for an increase in the Sum Price, he shall give the Architect written notice thereof within twenty days after the occurrence of the event giving rise to such claim. This notice shall be given by the Contractor before proceeding to execute the Work, except in an emergency endangering life or property, in which case the Contractor shall proceed in accordance with [Paragraph for procedures for emergency work]. No right to be paid any such increase shall ripen and no claim for such increase shall be valid unless notice is so made. Any change in the Contract Sum resulting from such claim shall be authorized by written Change Order.[5]

For a belt-and-suspenders approach to capping contractual liability of local governments, a contract should incorporate constitutional debt limitations. The Texas Constitution limits the power of cities and counties to incur "debt."[6] These limitations, however, have been held "not [to] extend to 'that class of pecuniary obligations in good faith intended to be, and lawfully, payable out of either the current revenues for the year of the contract or any other fund within the immediate control'" of the local government. *City of Houston v. Williams*, 353 S.W.3d 128, 139-40 (Tex. 2011) (quoting *McNeill v. City of Waco*, 89 Tex. 83, 33 S.W. 322, 323-24 (Tex. 1895)). "In practice, municipal contract expenses can be covered with current revenues." *Williams*, 353 S.W.3d at 140. To avoid the argument that the contract was intended to be paid out of current funds for the year, draftsmen should include both a stipulation that payment will be paid out of a specific fund duly appropriated for that purpose and a disclaimer of intent to pay for the project out of current funds or any other fund. A carefully worded appropriation provision will also facilitate defense of claims for contract adjustments that in aggregate exceed the total amount appropriated for the project.[7]

## IV. CHANGES & EXTRAS.

Construction rarely proceeds as planned because there are always unexpected events and conditions that occur during the job that affect the contractor's ability to complete the project as planned. These unexpected events — sometimes beyond the contemplation of the contracting parties — can prompt one or both parties to seek an adjustment of the agreed price, time, or work

[5] Adapted from similar provision discussed in *Ida Grove Roofing v. City of Storm Lake*, 378 N.W.2d 313 (Iowa App. 1985), where the contractor, who failed to stop work and obtain a change order before proceeding with additional work, was denied compensation in excess of the contract total price.

[6] *See* TEX. CONST. art. XI, § 5 ("no debt shall ever be created by any city, unless at the same time provision be made to assess and collect annually a sufficient sum to pay the interest thereon and create a sinking fund of at least two per cent thereon."); *id*., art. XI, § 7 ("no debt for any purpose shall ever be incurred in any manner by any city or county unless provision is made, at the time of creating the same, for levying and collecting a sufficient tax to pay the interest thereon and provide at least two per cent (2%) as a sinking fund").

[7] *See* TEX. LOC. GOV'T CODE § 252.048( b) (municipalities) ("The total contract price may not be increased because of the changes unless additional money for increased costs is appropriated for that purpose from available funds or is provided for by the authorization of the issuance of time warrants."); TEX. LOC. GOV'T CODE § 262.031(a) (counties) ("If it becomes necessary to make changes in plans, specifications, or proposals after a contract is made or if it becomes necessary to increase or decrease the quantity of items purchased, the commissioners court may make the changes. However, the total contract price may not be increased unless the cost of the change can be paid from available funds.").

requirements of the project.[8] As one commentator has noted:

> Ever since the advent of fixed price and fixed unit price construction contracts, at the forefront of every contractor's struggle to be competitive and stay in business has been the identification of potential "changed" work or "extra" work for which additional contract compensation and time could be obtained. Under pressures of competitive bidding, job profitability for the low bidder often has depended on the amount of additional compensation that could be obtained for work outside of the contractual undertaking.

1 BRUNER & O'CONNOR, § 4:1, p. 500.

Form construction contracts used for most large public projects contain elaborate procedures for making claims for contract adjustments for "changed" work or "extra" work. Changes and extras are commonly defined as follows:

> A "change" is defined as an alteration to an existing contract requirement concerning work that is already required to be done. An "extra", on the other hand, is an addition to the contract involving work that had not been included in the original contract. For example, if the owner and builder entered into a contract to build a house and an adjoining well, a subsequent agreement to dig the well five feet deeper would involve a *change*, while an agreement to build a second well would be considered an *extra*.

1 Goldberg & Banks, CONSTRUCTION LAW HANDBOOK, § 21.01 (1999).

## V. WRITTEN CHANGE ORDERS.

As discussed above, in government contracting, public bodies are not bound by the apparent authority of their agents. Change order authorization in government contracts must be founded on actual express authority, implied authority, or ratification. 1 BRUNER & O'CONNOR, § 4:42, p. 596. Authorization of a change is a crucial prerequisite to recovery under a contract. *See Uhlir v. Golden Triangle Development Corp.*, 763 S.W.2d 512 (Tex. App.—Fort Worth 1988, writ denied) (rejecting contractor's claim for extras because it failed to obtain written authorization for the work); *see also* TEX. LOC. GOV'T CODE ANN. § 271.153(a)(2) (damages from non-county local governments may be recovered "for the amount owed for change orders or additional work the contractor is directed to perform by a local governmental entity in connection with the contract").

Change or extra work clauses typically require a formal written order. However, it has been noted that "[t]he principle of strict enforcement of 'written order' requirements is now a pale shadow of its former existence." 1 BRUNER & O'CONNOR, § 4:39, pp. 587-88 (footnotes omitted). Since the mid-20th century, the courts have come to recognize the fundamental distinction between authorized changes and written changes, and generally they tend to enforce authorized orders in whatever form given under rationales such as (1) waiver of the writing requirement by course of dealing, (2) oral modification of the written contract by persons in authority, (3) estoppel. *Id.*

In an effort to shore up the effectiveness of a "written order" clause, contracts routinely include an "anti-waiver" clause that purportedly invalidates a waiver of any contract provision unless expressly in writing. The problem with this approach is that the doctrine of implied waiver cannot be negated by an express "anti-waiver" clause, since "anti-waiver" provisions are themselves subject to modification or waiver by persons with authority to do so. *See, e.g., Transpower Constructors v. Grand River Dam Auth.*, 905 F.2d 1413, 1419 (10th Cir. 1990); *see also Zwick v. Lodewijk Corp.*, 847 S.W.2d 316, 318 (Tex. App.—Texarkana 1993, writ denied) (recognizing that while an anti-waiver clause may itself be waived, it is some evidence of non-waiver).

Once again, the key to protecting the governmental entity from claims for unauthorized changes and extras is to carefully define and limit the powers of agents who can approve a change or extra and who can waive the procedural requirements for allowing it. An agent who lacks power to issue a change order cannot waive the formalities required to issue one. *See, e.g., Butler v. Board of Supervisors*, 659 So. 2d 578 (Miss. 1995) (county could not be bound by project engineer's unauthorized directive to perform extra work that was not approved by county

[8] Unexpected circumstances that often lead to claims for contract adjustment include: (1) owner-initiated changes in project requirements that materially affect design or construction performance or completion; (2) circumstances beyond the control of the parties, such as materially unexpected site or weather conditions, (3) material differences between contractually estimated and actually furnished material quantities; and (4) directions necessary to remediate design deficiencies.

board); *P&D Consultants, Inc. v. City of Carlsbad*, 190 Cal. App. 4th 1332, 119 Cal. Rptr. 3d 253 (2010) (contract requirement for written change orders could not be waived by project manager, and opining that "the purpose of including a written change order requirement in a municipal works contract is obviously to protect the public fisc from the situation that occurred here"); *Seneca Valley, Inc. v Village of Caldwell*, 808 N.E.2d 422, 432 (Ohio App. 2004) ("It is generally recognized that, in the absence of express authority, an engineer . . . or inspector in charge of or assigned to public building or construction work has no power to waive or modify a stipulation requiring a written work order for alterations, even where the person may authorize alterations in writing"); *Savignano v. Gloucester Housing Authority*, 344 Mass. 668, 183 N.E.2d 862 (1962) (affirming that agent lacked authority to waive contract provision requiring written order of housing authority for extra work).

Reserving the power to issue change orders and change work directives with the governing body builds into the contract the procedural requirements of the open meetings laws, since the governing body cannot lawfully act outside of a properly called meeting.[9] Texas open meetings laws cannot be waived. For similar reasons, anti-waiver provisions should be drawn so that only the governing body, by formal action, has power to waive any of the terms of the written contract on behalf of the entity; that none of the entity's other agents or officials, acting individually or collectively, can waive any written contract term. *See cf. Foster Wheeler Enviresponse, Inc. v. Franklin Cty. Convention Facilities Auth.*, 78 Ohio St. 3d 353, 678 N.E.2d 519, 528 (1997) (citing Annot., *Effect of Stipulation, In Public Building or Construction Contract, That Alterations or Extras Must Be Ordered In Writing*, 1 A.L.R.3d 1273, 1281-1282, Section 3 (1965) ("It is generally recognized that, in the absence of express authority, an engineer, architect, superintendent or inspector in charge of or assigned to public building or construction work has no power to waive or modify a stipulation requiring a written order for alterations, even where that person may authorize alterations in writing"); *Rissler & McMurry v. Sheridan Area Water Supply Joint Powers Board*, 929 P.2d 1228 (Wyo. 1996) (waiver of written change order requirement could not be shown absent evidence that the Board agreed to an alternate procedure). A stipulation in the contract can reaffirm that the entity, by entering the contract, has waived governmental immunity from liability, but only to the extent provided by the terms of the written contract; and that no officer or agent of the entity has the power to waive governmental immunity from liability beyond the terms of the written agreement.

## VI. NOTICES.

Construction and other contracts often contain a number of notice and reporting requirements. Contractors may be required to give notice of claims within a certain period. Another common notice provision requires written notice of encountering differing site conditions within a specified period of time. Under claims and conditions clauses in most standard form construction contracts, a contractor who desires to claim compensation for a constructive change is obligated to protest directions deemed to constitute changes by giving the owner prompt notice of the change.

Notice provisions in public works contracts serve a critical function:

> Timely notice of claims is a matter of fundamental fairness. Fairness inherent in timely notice permits the recipient of the notice to: (1) assess the implications and potential liability that may be created; (2) investigate whether the claimed item is truly an "extra" to the original contractual undertaking, (3) document costs incurred in performance of the extra work; and (4) fairly adjust the contract price before memories fade, documents are lost and facts recede into the construction haze.

1 BRUNER & O'CONNOR, § 4:35, p. 576. "The purpose of such notice is to obtain the other party's informed consent to the potential increase in its liabilities." *Id.*, p. 577.

Several of the states have construed written-notice-of-claims provisions strictly, to disallow price increases because in each, the contractor had failed to comply with their respective contract's notice requirements. *See, e.g., A.H.A. General Constr. v. NYCHA*, 92 N.Y.2d 20, 699 N.E.2d 368 (1998) ("These provisions . . . provide public agencies with

[9] Texas law facilitates this kind of procedure. *See* TEX. LOC. GOV'T CODE ANN. § 252.048(a) (municipalities) ("If changes in plans or specifications are necessary after the performance of the contract is begun or if it is necessary to decrease or increase the quantity of work to be performed or of materials, equipment, or supplies to be furnished, the governing body of the municipality may approve change orders making the changes."); *id.*, at § 262.0305 (county purchasing agent may negotiate modifications that must be approved by commissioners).

timely notice of deviations from budgeted expenditures or of any supposed malfeasance, and allow them to take early steps to avoid extra or unnecessary expense, make any necessary adjustments, mitigate damages and avoid the waste of public funds. Such provisions are important both to the public fisc and to the integrity of the bidding process."); *Cecio Brothers, Inc. v. Greenwich*, 156 Conn. 561, 244 A.2d 404 (1968) ("Had the plaintiff given timely notice in accordance with the terms of its subcontract, the contractor and the town would have had an opportunity not only then and there to have inquired into the accuracy of the plaintiff's claims as to the fill requirements but, more importantly, the town would have had an opportunity to save the added expense and keep within the limits of the public funds appropriated for the project by changing site plans or reducing costs in other portions of the project. If it is equitable for a plaintiff to recover extra compensation under the circumstances of this case, it is difficult to see how a municipality could ever protect itself from a contractor's unanticipated and long-delayed claim for compensation in addition to that provided by the contract and in excess of the public funds appropriated for a construction project."); *Starks Mechanical, Inc. v. New Albany-Floyd*, 854 N.E.2d 936 (Ind. App. 2006) (contract containing express language requiring notice of claims for delay damages enforceable where plaintiff failed to provide timely notice); *Mike M. Johnson, Inc. v. Spokane Cty.*, 150 Wash. 2d 375, 78 P.3d 161, 169 (2003) ("to hold that a contractor's notice of protest to the owner serves to excuse the contractor from complying with mandatory claim procedures would render contractual claim requirements meaningless. There would be no reason for compliance, as the contractor could merely assert general grievances in order to secure a later claim."); *Enviresponse v. Cty. Convention*, 78 Ohio St. 3d 353, 678 N.E.2d 519, 527-28 (Ohio 1997) ("The primary purpose of requiring written authorization for alterations in a building or construction contract is to protect the owner against unjust and exorbitant claims for compensation for extra work. It is generally regarded as one of the most effective methods of protection because such clauses limit the source and means of introducing additional work into the project at hand. It allows the owner to investigate the validity of a claim when evidence is still available and to consider early on alternative methods of construction that may prove to be more economically viable. It protects against runaway projects and is, in the final analysis, a necessary adjunct to fiscal planning."); *Razorback Contractors of Kansas, Inc. v. Board of Johnson County Comm'rs*, 43 Kan. App. 2d 527, 536, 227 P.3d 29 (2010) (affirming summary judgment against the contractor's claims for additional compensation due to changed conditions, because the contractor had "failed to provide notice of its claim in accordance with the parties' contract," noting that the line of decisions generally holding that written notice of changed conditions provisions should be strictly enforced.).

In drafting contract notice requirements, contract scriveners should spell out the procedures for giving notice – the form and content of the notice required, the time within which the required notice must be received, and the identity of the person who must be given the notice. Public entities should write contracts to require timely and sufficient notice of all circumstances that would trigger potential claims for additional time to perform the work or additional compensation under the contract. *See Starks Mechanical, Inc. v. New Albany-Floyd School Dist.*, 854 N.E.2d 936 (Ind. App. 2006) (contract required claims for delay damages to be perfected via contractual notice procedures; thus, contractor's failure to provide timely notice barred claim for delay damages caused by school district). To avoid a dispute over the legal effect of a failure to provide notice, the notice provision should be expressly denominated a condition precedent and worded substantively to deny the validity of any claim for a contract adjustment if notice is not given. *See, e.g., Cajun Constructors, Inc. v. Velasco Drainage Dist.*, No. 14-11-00004-CV, __ S.W.3d __, 2012 Tex. App. LEXIS 5396 (Tex. App.—Houston [14th Dist.] July 10, 2012, no pet. h.) (op. on reh'g) (contract term providing that "No claim for an adjustment in Contract Price or Contract Times (or Milestones) will be valid if not submitted in accordance with this paragraph" construed to be a condition precedent; hence, contractor who failed to provide notice was properly denied recovery for extras under contract).[10] Counsel should also consider whether to couple a notice requirement with an obligation on the part of the contractor to stop work pending a written work directive from the governmental entity.

In this context, it shall be recalled that contract

[10] A condition precedent is an event that must happen or be performed before a right can accrue to enforce an obligation. *Centex Corp. v. Dalton*, 840 S.W.2d 952, 956, 36 Tex. Sup. Ct. J. 153 (Tex. 1992). A party seeking to recover under a contract bears the burden of proving that all conditions precedent have been satisfied. *See Trevino v. Allstate Ins. Co.*, 651 S.W.2d 8, 11 (Tex. App.--Dallas 1983, writ ref'd n.r.e.); *City of San Antonio v. Guido Bros. Const. Co.*, 460 S.W.2d 155, 162-63 (Tex. Civ. App.—Beaumont 1970, writ ref'd n.r.e.).

law recognizes two types of conditions precedent: (1) those that must occur before a contract can be considered formed and (2) those that must occur before an obligation to perform an existing agreement can occur. *See Hohenberg Bros. v. George E. Gibbons & Co*., 537 S.W.2d 1, 3 (Tex. 1976). Notice provisions commonly found in form construction contracts are of the second type. *See Cajun Contractors, supra*. However, the notice procedure can be written as a condition precedent to the formation of a contract to pay any price increase over the agreed contract price. If the contractor fails to satisfy the notice requirement of this type, the argument could be made that the claim is extra-contractual, and thus, outside of the immunity-from-suit waivers afforded by TEX. LOC. GOV'T CODE §§ 262.007 and 271.152.

## VII. PRICE ADJUSTMENT PROVISIONS.

There are two types of price adjustment provisions that are frequently used in unit-priced construction contracts – variations in estimated quantities (VEQ) provisions and differing site conditions (DSC) provisions. *See generally*, 2 BRUNER & O'CONNOR ON CONSTRUCTION LAW §§ 5:114, 6:76, 7:205 (discussing variations in estimated quantities clauses); *id*, at vol. 4A, §§ 14:46-14:47 (discussing differing site conditions clauses). Each serves a distinct purpose and depends on proof of distinct facts.

A VEQ clause entitles a party to an adjustment of the unit price when the owner's quantity requirements deviate materially and significantly from the estimated contract quantity.[11] Its purpose has been stated as follows:

> Excessive variations over or below estimates stated in the contract, upon which bids were based, can be like games of chance; who is helped and who is hurt can depend on a number of factors, including (1) whether the units actually required are less or more than the base amount; (2) the extent to which the contract unit price approximates the actual unit cost to the contractor, of either the base or the adjustable units; (3) if the variation is due to an overrun, as here, whether and to what extent the unit cost for the overrun differs from the unit cost for the base units; and (4) the extent to which the contractor's unit cost for the base units is affected by the underrun or the overrun. When, in an overrun situation, the unit cost for the adjustable units proves to be less than the contract unit cost, it is the government that seeks the equitable adjustment, looking to that difference to measure the amount, the contractor arguing that the proper comparison is not with the contract unit cost but with the actual unit costs of the base units. When, on the other hand, the actual unit cost for an overrun variation is greater than the contract unit cost, the contractor seeks the equitable adjustment and it is the governmental entity that urges an actual cost versus actual cost comparison. If the variation arises from an underrun rather than an overrun, other considerations may also arise, depending on whether the unit cost of the reduced work is increased or decreased because of the reduction.

*Genstar Stone Paving Products Co., Inc. v. State Highway Admin*., 94 Md. App. 594, 618 A.2d 256, 260 (1993).

An adjustment under a VEQ clause must be based on the difference in cost directly attributable to the quantity variation, such as economies of scale. *See Foley Co. v. United States*, 26 Cl. Ct. 936, 939 (1992) (concluding that VEQ clause "requires the proponent of an adjustment to show that there are unit cost differentials between the base and excess units and that the differentials resulted from economies of scale associated with the quantity overrun."), *aff'd*, 11 F.3d 1032, 1034 (Fed. Cir. 1993); see also 2 BRUNER & O'CONNOR ON CONSTRUCTION LAW, at § 7:205.

By contrast, the purpose of a DSC clause is to "allocate to the owner the risk of site conditions which the contractor could not have anticipated by site investigation judged objectively reasonable under the circumstances." 4A BRUNER & O'CONNOR ON CONSTRUCTION LAW, at § 14:46; *see also H.B. Mac, Inc. v. United States*, 153 F.3d 1338 (Fed. Cir. 1998) (analyzing differing site conditions claim based on allegations that excavated materials were wetter than anticipated). To recover a price increase under a DSC clause, a contractor typically must prove that its

[11] The VEQ clause in many unit price contracts provides for an adjustment to the unit prices of the actual quantities that vary by more than a certain percentage from the estimated quantities. Federal procurement contracts use 15%. *See* 48 C.F.R. §§ 11-703(c), 52.211-16. Other contracts stipulate even wider variations. *See State Highway Admin. v. David A. Bramble, Inc.*, 351 Md. 226, 717 A.2d 943, 948 n.7 (1998) (contract providing for adjustment where the actual quantity of the unity pay item varies more than 25 percent above or below the estimated quantity stated in this contract).

increased performance costs were attributable to the materially different subsurface conditions. *See Renda Marine, Inc. v. United States*, 66 Fed. Cl. 639, 656 (Fed. Cl. 2005) (and cases cited).

In contracts that allow claims for price adjustments under provisions of this sort, care must be taken to set a high and clear minimum threshold for seeking an adjustment. Consider for example the following VEQ clause in the EJCDC C-700 form construction contract:

> Owner or Contractor may make a Claim for an adjustment in the Contract Price in accordance with [contract notice requirements] if:
>
> 1. The quantity of any item of Unit Priced Work performed by Contractor differs materially and significantly from the estimated quantity of such item indicated in the Agreement; and
>
> 2. there is no corresponding adjustment with respect to any other item of Work; and
>
> 3. Contractor believes that Contractor is entitled to an increase as a result of having incurred additional expense or Owner believes that Owner is entitled to a decrease in the Contract Price and the parties are unable to agree as to the amount of any such increase or decrease.

Because this provision contains no clear objective standard for determining whether the quantity of actual units performed differs "materially and significantly" from the bid estimates, the provision invites a lawsuit with an unpredictable outcome in situations where the variation is arguably immaterial and insignificant. Now consider the following relevant language from a VEQ provision used in federal unit-priced contracts:

> If the quantity of a unit-priced item in this contract is an estimated quantity and the actual quantity of the unit-priced item varies more than 15 percent above or below the estimated quantity, an equitable adjustment in the contract price shall be made upon demand of either party. The equitable adjustment shall be based upon any increase or decrease in costs due solely to the variation above 115 percent or below 85 percent of the estimated quantity.

48 C.F.R. § 52.212-11. This VEQ provision preserves the intent of unit-pricing by requiring the parties to assume the risk that the actual quantities performed may vary from bidding estimates within a specified range, with neither party entitled to sue for a price adjustment. If a variation occurs outside of the agreed upon range of deviation, then an adjustment can be made, but only for an amount that represents a change in the contractor's per-unit costs that is attributable to the deviation in quantities. This VEQ provision cannot be used to adjust the contractor's profit margin.

As with the notice and change order procedures that protect the governmental unit from claims based on changes and extras, the same holds true for these types of price adjustment provisions. The right to any price adjustment should be expressly conditioned on work stoppage, full satisfaction of the contractual written notice procedure, and a written order by the governmental entity to proceed with the work. Only in that situation can it be fairly said that the governing body authorized the work and assented to a potential price increase for it.

## VIII. INDEMNITY, INSURANCE, AND THIRD-PARTY BENEFICIARIES.

Even absent express statutory authorization, local governments have the implied authority to indemnify their officials and employees against tort claims. 4 Sands & Libonati, LOCAL GOVERNMENT LAW § 27.30, at 27-173 (1995); 3 McQuillan, THE LAW OF MUNICIPAL CORPORATIONS, § 12.137, 12.137.10. According to Texas courts, since the express power to appoint or hire a city employee or officer carries an implied power to provide suitable means to protect that person in the discharge of his official duties, a city may protect the individual by providing indemnification from liability and by funding his legal defense. *See City of Corsicana v. Babb*, 290 S.W.2d 736, 737 (Tex. Comm. App. 1927). Expenditures made for these purposes are not an unconstitutional gratuity, but constitute a public expense of the municipality for which city funds may be used. *Id.*

Under the rationale of *Babb*, one may fairly conclude that to the extent a governmental unit has the express power to appoint or hire a gratuitous employee, or a volunteer, to carry out that entity's functions, the governmental unit may also protect that volunteer by indemnifying him from liability for torts committed in good faith in the course and scope of his official duties, and by furnishing him with legal counsel to assist him in the defense of any such tort claims made against him.

Contracts that require a governmental entity to indemnify an independent contractor from its own fault, however, are arguably invalid. Courts of several jurisdictions, Texas included, have stated in sweeping language that cities lack the power to carry casualty and indemnity risks for private individuals or other corporations. *See, e.g., Galveston, H. & S.A. Ry. v. Uvalde County*, 167 S.W.2d 305 (Tex. Civ. App.—San Antonio 1942, writ ref'd w.o.m.); 10 McQuillan , THE LAW OF MUNICIPAL CORPORATIONS § 29.06 (3d ed.); *Wheeler v. City of Sault Ste. Marie*, 129 N.W. 685 (Mich. 1911). In *Uvalde County*, a railroad company sued a county to enforce an indemnity agreement, and the court held that the agreement was *ultra vires* and, thus, unenforceable. The county (which, as a creature of statute, is analogous to a general law city or district) had entered a contract with the railroad whereby the railroad agreed to permit the county to build a dipping vat on the railroad's property, and, in exchange, the county had agreed to indemnify the railroad from any and all damages it sustained by reason of the vat's location on the railroad's property. Although the court noted that the county had the express power to locate and construct the dipping vat to protect the public from a health hazard, that express power "did not give [the county] the right to go into the insurance business in connection therewith." *Id.*, at 306. Reasoning from the proposition stated in McQuillan's treatise that "a city cannot indemnify other corporations against risks," the court concluded that "certainly a county cannot do so." *Id.* The court also reasoned that the indemnity agreement created a potentially unlimited obligation that the county might not be able to fund.