

UCC §2.615 AND "COMMERCIAL IMPRACTICALITY"

Recent natural disasters have contributed to volatile pricing conditions within the construction industry and contractors are sometimes unwilling or unable to honor purchase order prices due to price increases they receive from their manufacturers. Many contractors seek to protect themselves in the purchase orders by making their quote revocable after a short period of time or by including language to the effect that the contractor is excused for delays and is entitled to a change order if it is unable to secure suitable or sufficient material from its customary sources.

If the contractor has no protection built into the purchase order, the contractor will claim that §2.615 of the Texas Business and Commerce Code excuses its performance. In order to successfully invoke §2.615, the seller must establish that

- a. an unexpected event or "contingency" occurred;
- b. the non-occurrence of the contingency was a basic assumption of the Contract and was not allocated by agreement or custom;
- c. the occurrence rendered performance impracticable.

§2.615 of the Uniform Commercial Code is generally recognized as having replaced the pre-code standard of impossibility of performance with a less strict standard of impracticability of performance. (55ALR 5th 1) The essence of the defense is whether or not the contingency which developed is one which the parties could reasonably be thought to have foreseen as a real possibility that could affect the performance. Further, if the seller is able to partially perform, 2.615(b) imposes a duty to fairly and reasonably allocate production and deliveries among his or her customers. §2.615 also explicitly contemplates that there will be no excuse from performance, even if performance as contemplated becomes impracticable, if alternative or substitute performance contemplated by §2.614 may be accomplished.

In *Robberson Steel, Inc. v. JB Abrams*, 582 S.W.2d 558 (Tex.Civ.App.-El Paso 1979, no writ) a mill at Armco Steel Corporation unexpectedly broke down and Robberson was unable to deliver steel as required to meet the terms of its purchase order. Robberson had contracted with JD Abrams to furnish steel for four bridges for the Texas Highway Department. The court found that the important question when dealing with a Section 2.6.15 defense is whether or not the unanticipated circumstance has made performance of the promise vitally different from what should reasonably have been within the contemplation of both parties when they entered into the contract. Because the purpose of the Contract is to place the reasonable risk of performance on the promisor, the promisor is presumed, in the absence of evidence to the contrary, to have agreed to bear any loss occasioned by an event which was foreseeable at the time of contracting. Underlying the court's reasoning is the view that a promisor can protect himself against foreseeable events by means of an express provision in the agreement. The evidence in the case showed that Robberson carefully confirmed with the mill prior to submitting its bid that steel would be available and that Robberson's quote to the contractors contained the wording "delivery is subject to our ability to procure steel from our steel mill contractors." The fact that Robberson chose not to incorporate those provisions in the purchase order led to the court's judgment that Robberson foresaw the risk. If the risk was foreseeable, there should have been a provision for it in the contract and the absence of such a provision gives rise to the inference that the risk was assumed by the contractor.

The case of *Tractebel Energy Marketing, Inc. v. E.I. Dupont DeNemours & Co.*, 118 S.W3d 60,

64 (Tex. App-Houston 2003, pet. denied) is an interesting example of the doctrine of impracticality in Texas. In that case the Plaintiff wished to build a power plant. EPA regulations required new power plants to offset the anticipated increase in overall emissions by purchasing emission reduction credits. Entities acquired those credits by installing better technology in existing plants or shutting down existing operations. Plaintiff contracted with Defendant to buy 1,000 tons of NOx emission credits in March of 1998. Shortly thereafter, the New Jersey Department of Environmental Protection revoked Defendant's credits, citing new regulations. Defendant alleged that the Doctrine of Commercial Impracticability insulated it from Plaintiff's resulting breach of contract action. The court held that such an excuse is limited to circumstances in which both parties hold a basic (though unstated) assumption about the contract that proves untrue. For example, the court cited the case where the death or incapacity of a person involved makes a contract for personal services impracticable. The court found that while Defendant clearly had its own credits in mind when it entered the contract, there had to be evidence the Plaintiff also viewed this to be a basic assumption of the contract before the doctrine of commercial impracticality would operate as a defense. The court found that the contract did not specify the source or ownership of the credits being sold and there was no prior dealings of the parties which could have provided evidence in that regard. The court cited the following two examples from RESTATEMENT (2ND) of CONTRACTS §261 to illustrate its opinion:

- a. a farmer's agreement to sell milk under a contract that does not specify the source is not discharged if the farmer's herd is subsequently destroyed due to disease
- b. a manufacturer's contract to sell a product it makes is not discharged by the destruction of its factory so long as product meeting the contract is available elsewhere on the market.

Defendant could have purchased credits from another source and fulfilled the terms of the contract and there was no evidence that Plaintiff contracted on the assumption that Defendant's credits, and only those credits, were subject to the contract. The case of *United Sales Co. v. Curtis Peanut Co.* 302S.W.2d 763, 766 (Tex.Civ.App. - Dallas 1957, writ refused, nre) was cited for the proposition that "it is not enough to show merely that the cause of events occurring since the making of the contract makes it impossible to obtain a commodity contracted for from a source contemplated by the parties, where the contract does not specify that the commodity is to be obtained there, even though it would have been more expensive to obtain it elsewhere."

When the contractor qualifies its bid to an unacceptable degree, it may be necessary to negotiate an acceptable price escalation clause. The following type of clause is in general use under those circumstances:

"The Parties agree that the Supplier has based its bid on certain pricing assumptions of materials to be incorporated into the Work. However, the market for products that are specified below is considered by both Parties to be volatile, and sudden price increases could occur that are beyond the control of the Supplier, despite its best efforts. Therefore, the Parties agree that if there is a bona fide price increase to the Supplier of the material(s) listed below by more than _____% of the specified unit price, through no fault of the Supplier, the Supplier may, prior to obtaining or contracting for the purchase of the materials, request and obtain an equitable adjustment to this Contract, which adjustment shall increase the price per unit to an amount equal to _____% of the price. An equitable adjustment will not be unreasonably withheld by the Contractor. Evidence of material price increases shall be provided and documented by vendor quotes, invoices, catalogues, receipts or other documents of commercial value as may reasonably be requested by Supplier."

IMPLIED WARRANTY OF GOOD AND WORKMANLIKE CONSTRUCTION IN COMMERCIAL CONTRACTS WHAT DOES IT MEAN AND HOW CAN ITS EFFECT BE REDUCED?

The implied warranty of good and workmanlike construction requires the builder to construct the structure in the same manner as would a generally proficient builder engaged in similar work performed under similar circumstances. It is a well established legal principle that the implied warranty of good and workmanlike construction exists in a residential construction contract. *Humber v. Morton* 426 S.W.2d 554 (Tex.-1968). The trend in law appears to be to extend this implied warranty to commercial construction. In *Barnet v. Coppell N. Tex. Court Ltd.* 123 S.W.3d 804, 823 (Tex.App-Dallas 2003, pet.denied) the court dealt with a dispute surrounding the North Texas Gymnastics Academy in Coppell, Texas. Without discussion, the court applied the good and workmanlike warranty to commercial construction but held that the implied warranty is a "gap filler" or "default warranty" and that therefore, the warranty may be avoided by express contractual provisions. (See also *Continental Dredging v. DE-Kaizered, Inc.* 120 S.W.3d 380 (Tex.App - Texarkana 2003, pet. denied); *James Holmes Enterprises, Inc. v. John Bankston Construction and Equipment Rental, Inc.* 664 S.W.2d 832,835 (Tex. App. - Beaumont 1983, writ refused, nre)) In the residential context, the Texas Supreme Court has held that the implied warranty of good and workmanlike construction cannot simply be disclaimed; however, if the parties clearly express a contrary intention and provide for the manner, performance and poor quality of the desired construction, the warranty can be avoided. *Centex Homes v. Buecher*, 95 S.W.3d 266, 273 (Tex. 2002). The Barnet court recognizes that the same principles will apply in the commercial context.

The one year correction warranty contained in paragraphs 12.2.2.1 and 12.2.5 of AIA-A201 (1997 ed.) is not enough to avoid the implied warranty of good and workmanlike construction. Those provisions simply add a contractual requirement to fix problems within one year. The Contractor's duty to affirmatively correct defective work is independent of a possible claim by the Owner for damages arising from said work. Where the contract fails to expressly exclude the Owner's common law remedies, or to limit remedies to those expressly stipulated in the contract, a party may still invoke independent remedies.

The Contractors desire to limit the express warranty in a contract must be tempered by the fact that such a warranty must be sufficiently expansive so that a coterminous disclaimer of implied warranties will be effective under the "gap filler" line of cases above. Language such as the following should be sufficient to achieve the Contractor's aims: "Contractor warrants its work against failure due to defective workmanship or materials for a period of one year from completion date. Contractor does not warrant products which are not manufactured by Contractor except to the extent of the warranty Contractor actually receives from the manufacturer and such warranties are hereby assigned. Contractor's liability shall be limited to this written warranty and OWNER AGREES TO ACCPET SAID WARRANTY IN PLACE OF ALL OTHER WEARRANTIES, EXPRESSED OR IMPLIED, INCLUDING BUT NOT LIMITED TO THE IMPLIED WARRANTY OF GOOD AND WORKMANLIKE CONSTRUCITON. Owner agrees that Contractor is relying on this waiver and would not enter in to this contract without this waiver." (See *Richardson v. Duperier*, 2005 WL 831745 (Tex. App.-Houston 2005).)

The assignment of warranties for materials is governed by the UCC (§2.2.10(b)). If the implied warranty of good and workmanlike construction is not effectively disclaimed, an action for breach of contract is governed by the four year statute of limitations Tex. Civ. Prac. & Rem. Code Ann. Sec. 16.004 (Vernon 1986). It commences to run from the time of the breach of contract, or from the time when the plaintiff has knowledge of the breach, whichever is the latter, unless his lack of knowledge resulted from his lack of diligence or from negligence. Actions for breach of expressed or implied warranties are also governed by the four year statute of limitations and the discovery rule. When implied warranties have been waived and the express one year warranty for defects is over, the contractor is faced with the basic contract limitation period of four

years. Tex. Civ. Prac. & Rem. Code Ann. Sec. 16.004 (Vernon 2003) -discussion of discovery rule and statute of repose (Tex. Civ. Prac. & Rem. Code Ann. Sec. 16.009 (Vernon-2003)).

An interesting factual situation concerning the issues raised in this article is provided by PPG Industries, Inc. v. JMB/Houston Centers Partners. L.P., 146 S.W.3d 79 (Tex. 2004). In that case, PPG manufactured and installed 12,000 dual-pane glass window units on One Houston Center, a 46 story skyscraper in downtown Houston. The project was completed in April of 1978. PPG provided a five year express warranty offering to repair and replace any defective product. Under the UCC, breach of implied warranty claims must be brought within four years of delivery and breach of express warranty claims must be brought within four years of delivery unless the express warranty is explicitly extended so that it guarantees future performance. (Texas Business & Commerce Code 2.725(b)). Where, as in this case, the express warranty is extended, the accrual of the breach of warranty cause of action occurs when the breach should have been discovered. Thus, in this case, the breach of express warranty action could be brought late as nine years after delivery rather than four years. PPG replaced one fourth of the windows in 1982 after they showed fogging and discoloration. The suit was not brought within four years after the repair work and the owner contended that it did not learn until much later that the problem was defective design and thus extended to every window in the building and not just the windows that were repaired. The court ruled that the case was barred by the statute of limitations because "the discovery rule does not linger until a claimant learns of actual causes and possible cures." Limitations begin when claimant learns of a wrongful injury; even if the claimant does not know the specific cause of the injury, the party responsible for it, the full extent of it, or the chances of avoiding it. The court held that a few isolated defects would not have established discovery as a matter of law and the case of R.W. Murray Co. v. Shatterproof Glass, Corp., 758 Fed.2d 266 273 (8th Cir. 1985) was distinguished. In that case, the Eighth Circuit held that 23 defective windows on a project involving 2004 windows did not establish as a matter of law that the buyer should have known the windows were defective.

CONTRACTOR RESPONSIBILITY FOR MATERIAL DEFECTS

It is not uncommon for construction materials to fail even though they have been installed in a good and workmanlike manner in strict accordance with the plans and specifications and in strict accordance with manufacturer's recommendations. Under such circumstances, can the general contractor be held liable by the owner for damages incurred as a result of the failure? The answer depends upon contractual language and whether it was a design error; i.e. whether to not the material would have failed even if there had not been a manufacturing defect.

Most jurisdictions hold that the Owner impliedly warrants the adequacy of its design. The landmark case of *United States v. Spearin*, 248 U.S.132 (1918) is now followed in almost every jurisdiction. In that case, the governments detailed plans and specifications required that Spearin expedite the site and relocate and reconstruct a 6 foot brick sewer line that intersected the site. After the sewer was relocated and reconstructed, heavy rains caused it to back up, which, in turn, created internal water pressures that broke the line in several places and flooded the excavation. Based upon a contract clause that made Spearin responsible for the work until completion and acceptance, the Government insisted that Spearin clean up the site and reconstruct the damaged line at its expense. The United States Supreme Court ruled that the Government was liable for breach of its implied warranty of the adequacy of the plans and specifications and affirmed an award to the general contractor. The *Spearin* court held, in part: "Where one agrees to do, for a fixed sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation, because unforeseen difficulties are encountered. *Day v. United States*, 245 U.S. 159; *Phoenix Bridge Co. v. United States*, 211 U.S.

188. Thus one who undertakes to erect a structure upon a particular site, assumes ordinarily the risk of subsidence of the soil. *Simpson v. United States*, 172 U.S. 372; *Dermott v. Jones*, 2 Wall. 1. But if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications. *MacKnight Flintic Stone Co. v. The Mayor*, 160 N.Y. 72; *Filbert v. Philadelphia*, 181 Pa. St. 530; *Bentley v. State*, 73 Wisconsin, 416. See *Sundstrom v. New York*, 213 N.Y. 68. This responsibility of the owner is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work, as is shown by *Christie v. United States*, 233 U.S. 414, 424, where it was held that contractor should be relieved, if he was misled by erroneous statements in the specifications.

The classic situation where the Spearin doctrine is invoked is where the Owner specifies a particular product which proves to be unsuitable for the use for which it was specified. To avoid the implied warranty of plans and specifications, owners often times use performance specifications.

Texas is one of the few jurisdictions where the Spearin reasoning has not been adopted. In Texas, there must be contractual language indicating intent to shift the burden of risks to the Owner in order to find that an Owner breached a contract by providing defective plans and specifications. *Lonegran v. San Antonio Loan and Trust Co.*, 104 S.W.1061 (Tex. 1907); *Interstate Contracting Corp. v. City of Dallas*, 407 Fed.3d 708 (5th Circ. 2005). There is no clear owner's warranty of plans and specifications in AIA documents; however, 3.2.3 of AIA A-201 states, in part, that "the Contractor shall not be liable to the Owner or an Architect for damages resulting from errors, inconsistencies or omissions in the Contract Documents..." At least one Texas court has held that similar language imposes an obligation on the Owner to "guarantee" the sufficiency of the plans and specifications. *North Harris County Junior College District v. Fleetwood Construction Company*, 604 S.W.2d 247, 253 (Tex. Supp.App. Houston 1980, writ refused n.r.e)

The Spearin case applies where the specified product fails because it is unsuitable for the designed application. The case becomes more problematic where the specified product fails due to a manufacturing defect. In general, the Contractor is held responsible for product failures as contrasted to failures caused by the unsuitability of a material for the design application. Some cases cite contractual language whereby the Contractor accepted the risk of defective materials. For example, §3.5.1 of AIA-201 states: "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 free from defects not inherent in the quality required or permitted and the work will conform to the requirements of the Contract Documents..." Some courts simply decline to extend an Owner's design warranty to the performance of third party contractors and manufacturers utilizing the reasoning that a Contractor is better able to seek recovery from a defaulting manufacturer than the Owner which has no direct contractual relationship with said manufacturer.

The case of *Rhone, Poulenc, Rorer Pharmaceuticals, Inc.; Turner Construction Co. v. Newman Glassworks*, 112 Fed. 3d 695 (3rd Circ. 1997) provides an interesting illustration of the above points. In that case, Turner, as the general contractor, subcontracted with Newman to install opaque spandrel glass that comprised the structures curtainwall. The subcontract specified the type of glass that Newman was to install and specified that all work will be "free from faults and defects." Newman installed the glass specified and installed it in a good and workmanlike manner; nevertheless, the opacifier coating began to delaminate from portions of the glass. Newman asserted that under the Spearin decision discussed above, it could not be held liable for defects in the glass because it complied with specifications in the subcontract. The

court held that implied warranties are generally not favored by law and are construed narrowly. Where the parties explicitly allocated to Newman the risk that the glass would be defective, the express warranty governed. If the express warranty had been qualified as is 3.5.1 of AIA-201 so that the obligation to correct defective work excluded defects "not inherent in the quality required or permitted" or if the express warranty had been qualified so that "defects" were defined as work not conforming to the contract documents, the result would most assuredly have been different. Further, in the 2005 case of Travelers Indemnity Co. v. S.M. Wilson & Co., 2005 WL 2234582 (E.D. Mo. 2005), the Court cited the dissent in Rhone and reached the opposite conclusion.

In light of the legal difficulty in avoiding responsibility for defective materials, contractors must be very careful in negotiating the terms of purchase orders. Sections 2.718 and 2.719 of the Texas Business and Commerce Code allow buyers and suppliers to set limits on damages, establish liquidated damages and caps on those damages and substitute remedies in addition to those provided for in the Code. Suppliers frequently disclaim implied warranties of merchantability and fitness for a particular purpose and limit the buyer's remedies to the return of goods, repayment of the price, or to repair and replacement of non-performing goods and to the exclusion of consequential damages. When faced with such a limitation, contractors must at least address the cost of getting to, removing and replacing the goods and damage to the surrounding work, equipment or structures.