Your General Counsel, Defective Plans, a Dive into *Spearin* and some very odd Texas Law

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One of the primary roles of a company's general counsel is risk management. And "risk" should be understood in its broad everyday sense—the chance of something bad happening. Construction companies, and their general counsels manage risks several different ways. Those include building and maintaining an insurance program; reviewing and negotiating the company's contracts, including subcontracts, vendor purchase orders, and lease agreements; and managing the company's disputes through negotiation, mediation, arbitration, and litigation.

Insurance is a primary risk management tool. The general counsel will assist with designing and procuring insurance, drafting the insurance requirements for lower tier agreements, and making insurance claims. Insurance provides a hedge to a variety of risks, for example, employee accidents, damage by third parties, employee bad behavior, bad weather, professional errors, and malpractice. Importantly, it not only can protect the company by paying claims, but it will also pay the legal costs of litigating claims.

The contracts a company executes are a significant source of risks that concern a general counsel. The general counsel will review contracts and negotiate terms and conditions to get an acceptable balance of risk and reward, with insurance provisions frequently part of these contract agreements. Then, while the substance of the contract is being performed, the general counsel will advise the company's managers how the contracts govern the parties' rights and responsibilities, especially when the unexpected happens like a defect in plans and specifications.

When a contract or other risk issue results in a claim, general counsel will advise those assembling the claim about relevant limits and deadlines and how to avoid traps like the federal government's False Claims Act. If the issue is litigated, the general counsel will hire and manage specialty outside counsel to handle the adjudication of the dispute—sometimes in mediation and usually in arbitration or trial.

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Spearin Doctrine

Errors in contract documents, primarily plans and specifications, are an issue that a construction company's general counsel deals with frequently, and they are a frequent genesis of claims and litigation. Texas has an unusual history with this issue, which, in the rest of the country, has been guided by the legal principle known as *Spearin* Doctrine.

Spearin Doctrine addresses the issue of defective plans and specifications for a construction project, where the owner provides plans and specifications to the contractor, and neither the owner nor the contractor created the plans and specifications. Its name comes from the 1918 U.S. Supreme Court decision, *United States v. Spearin*.[2] Spearin contracted with the U.S. government to build a dry-dock for the Navy in Brooklyn using the government's plans and specifications.[3] The plans required Spearin to relocate a six-foot diameter sewer line.[4] A year into the project, heavy rain and high tides caused the relocated sewer line to burst.[5] The ultimate cause of the failure was discovered to be a five to five and one-half foot dam, not shown on the plans, in an existing section of seven foot sewer that diverted too much water into the relocated line.[6] The government said it was Spearin's problem. Spearin said it was the government's problem. Litigation ensued.[7]

The Supreme Court decided the case in favor of Spearin, holding that "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."[8] The Court also wrote that, "[T]he insertion of the articles prescribing the character, dimensions and location of the sewer imported a warranty that, if the specifications were complied with, the sewer would be adequate."[9]

As noted above, this was a dispute between the U.S. Navy and a contractor on a government project. This makes the Supreme Court's decision binding on cases under federal contract law. It has no binding effect on private contracts or on a state court deciding cases under

[2] 248 U.S. 132 (1918)
[3] *Id*. at 133.
[4] *Id*. at 133-134.
[5] *Spearin* at 134.
[6] *Id*.
[7] *Id*. at 135.
[8] *Id*. at 136.
[9] *Id*. at 137.

state law.[10] That said, *Spearin* has been widely cited[11] and has been persuasive. Even where it is not binding, most states have adopted the doctrine as generally applicable though they and federal courts have also allowed it to be contracted around.[12] That is, courts have enforced contract provisions that expressly made contractors liable for errors in the owners' plans.[13]

Spearin **in Texas (or not)**

Texas, as it is prone to do in many things, has had its own unique take on *Spearin* Doctrine. The easy take is that Texas stood *Spearin* on its head, making the contractor, not the owner, responsible for the consequences of defects in the plans and specifications. The infamous case with this holding is *Lonergan*,[14] decided by the Texas Supreme Court a decade before *Spearin*.

Thomas Lonergan & Company was a contractor from Chicago hired in 1899 by San Antonio Loan and Trust Co. ("SALT") to build a building at the corner of Commerce and Navarro.[15] The building collapsed when partly constructed due to design and plan errors, and SALT sued Lonergan.[16] The case has an interesting history and an interesting cast of characters including the prominent San Antonion who owned SALT, the bankrupt Lonergan company, and the SALT attorney who was a former Texas Supreme Court justice. He had served with the justice who wrote the decision in favor of SALT.[17]

Lonergan, the case, can be best understood as an example of Lonergan, the contractor, getting hometowned. The Texas Supreme Court, after noting the building plans were defective found that the contractor had as much opportunity as the owner to decide whether he was "satisfied" with the building's plans and specifications.[18] Furthermore, the Court believed the

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[10] *See, e.g., Stabler Constr., Inc. v. Commonwealth*, 692 A.2d 1150, 1153 (Pa. Commw. Ct. 1997).
[11] As of January 4, 2024, Lexis noted 1033 citing decisions, including 251 in state courts.
[12] See, e.g., Lauren P. McLaughlin and Shoshana E. Rothman, *When Spearin Won't Work: How Contractual Risk Allocation often Undermines this Landmark Ruling*, 35 SUM Construction Law 39, Construction Lawyer (Am. Bar Association, Summer 2015).
[13] See *id*. at 40-42.
[14] *Lonergan v. San Antonio Loan & Tr. Co.*, 101 Tex. 63, 74 (1907).
[15] Fred D. Wilshusen, Misty H. Guitierrez, and Jaco B. Damrill, *The Rest of the Story: The Fascinating Backstories behind Lonergan and Spearin*, 14 Constr. L. J. 3, 10 (State Bar of Texas, Winter 2018).
[16] *Lonergan* at 66-68.
[17] *See* Wilshusen, et. al, *supra* at 10.
[18] *Lonergan* at 74

contractor was "probability much better" able to discover any defects in the architect's work than the owner was.[19]

The Court went on to hold:

> We are of opinion that [the contractor], having failed to comply with their agreement to construct and complete the building in accordance with the contract and the specifications, **must be held responsible for the loss**, **notwithstanding** the fact that the house fell by reason of its weakness arising out of **defects in the specifications** and without any fault on the part of the builder.[20]

The logical inconsistency of this decision—the contractor must build per plans and specification but must also deviate from plans and specification if necessary to build the project—seems to have escaped the Texas Supreme Court.

In the ensuing decades, observers of Texas law could be forgiven for assuming that the Texas Supreme Court had implicitly abandoned *Lonergan's* holdings. This view would be well supported as of 1971 when the Court let stand an appellate decision in *Newell v. Mosley* that stated:

> Subject to some exceptions, if a party furnishes specifications and plans for a contractor to follow in a construction job, he thereby impliedly warrants their sufficiency for the purpose in view, particularly if the party furnishing the plans is the owner.[21]

The Texas Supreme Court denied the request to review the *Newell* decision, finding no reversible error.[22] Any observers that assumed this buried *Lonergan* would have been wrong. In a 2012 decision, the Texas Supreme Court reinvigorated *Lonergan* in a case generally known as *MasTec*.[23]

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[19] *Id.*
[20] *Id.* at 76
[21] *Newell v. Mosley*, 469 S.W.2d 481, 483 (Tex. Civ. App. 1971, writ ref'd n.r.e).
[22] *Id.*
[23] *El Paso Field Servs., L.P. v. MasTec N. Am., Inc.*, 389 S.W.3d 802 (Tex. 2012)

The *MasTec* case is a pipeline dispute. El Paso Field Services hired MasTec to replace a sixty-eight mile long deteriorated propane pipeline constructed in the 1940s.[24] El Paso's plans showed approximately two hundred eighty utility interferences identified by El Paso's surveyor.[25] Once construction began, MasTec found three times as many utility interferences.[26] The majority of the justices were unsympathetic, finding that, "as in *Lonergan*, El Paso did not guarantee the accuracy" of its surveyor's work.[27] The Court implicitly ignored that it had found no reversible error in the *Newell v. Mosely* decision that had said an owner *does* implicitly warrant the accuracy of the information it provides.

This result was a wake-up call to attorneys and especially general counsels in Texas. Though the decision spent most of its ink discussing the contract language and which party had *contractually* agreed to be liable for errors, the Court's citation and endorsement of *Lonergan* put attorneys and Texas's lower courts on notice that the drift from *Lonergan* was at an end. Contractors and their general counsels would be expected to carefully review building contracts for language about plan and specification defects and ensure the terms stated that the owner, and not the contractor, was liable for defective plans and specifications or the law would make contractors liable for those issues.

The Texas Legislature Steps In

After almost a decade of lobbying by Texas contractors to overturn *Lonergan*, the Texas Legislature passed Senate Bill 219 in 2021, which both overturned Lonergan—in some respects— and clarified how design liability *must* be allocated for most building and roadway projects.[28] The statute was codified in Business and Commerce Code, Title 4, Chapter 59.

The statute has several interesting aspects, and there are related statutes regarding designers' standard of care[29] that mollified some designer opposition to Chapter 59's allocation of design liability. The first thing to notice is that the new law does not apply to industrial

[24] *Id*. at 803.
[25] *Id*. at 803.
[26] *Id*. at 812 (Guzman, J., dissenting).
[27] *Id*. at 811.
[28] See 2021 Bill Text TX S.B. 219
[29] *Id*. at Section 3, *see also*, Tex. Civ. Prac. & Rem. Code § 130.0021.

facilities, design-build, or engineer-procure-construct contracts.[30] This is in some respect due to a successful lobbying effort by Exxon/Mobil, but it makes sense in a larger sense in that those facilities are often designed and constructed by a single entity or have more complicated designer-builder relationships than the a design-bid-build project like the one at the center of *Lonergan*.

There have not been any cases interpreting the statute, so how it will be interpreted by the courts remains an open question, but some provisions seem clear on their face: "A contractor is not responsible for the consequences of design defects" for documents provided to it by an owner.[31] Furthermore a contractor is prohibited from warrantying "the accuracy, adequacy, sufficiency, or suitability of plans, specifications, or other design documents."[32] Contracts that would include terms making a contractor liable for design defects are "void."[33] However, the contractor is not completely off the hook. If it learns of a "defect, inaccuracy, inadequacy, or insufficiency" or it should have "reasonably … discovered" the issue "using ordinary diligence," then the contractor will be liable.[34]

An interesting issue that may be litigated (and perhaps already has been argued in confidential arbitrations) is how the statute meshes with standard contract clauses. For example, § 6.2.2 of the AIA A201 *General Conditions* states that a contractor "shall, prior to proceeding with that portion of the Work, promptly notify the Architect of **apparent** discrepancies or defects."[35] The contractor is not responsible "for discrepancies or defects … that are not **apparent**."[36] Whether "apparent" means the same as discoverable using "ordinary diligence" is an interesting question; however, under this Texas law, the statute overrules the contract language. Even if the parties believe "apparent" means more-obvious-than-could-be-discovered under "ordinary diligence," the law cannot be contracted around—different language is "void."[37]

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[30] *See* Tex. Bus. & Com. Code § 59.002(b). "Critical infrastructure" is defined in Tex. Bus. & Com. Code § 59.001(3).
[31] Tex. Bus. & Com. Code, § 59.051(a).
[32] *Id*.
[33] *See id*. at § 59.003.
[34] *Id*. at §§ 59.051(b) and 59.051(c).
[35] AIA A201, *General Conditions of the Contract for Construction*, § 6.2.2, p. 21 (American Institute of Architects, 2017) (emphasis added).
[36] *Id.* at 22 (emphasis added).
[37] *See* Tex. Bus. & Com. Code, § 59.003.

EJCDC's standard general conditions have similar terms but would likely run afoul of Texas law. It states the contractor "shall not be liable … for failure to report any conflict, error, ambiguity, or discrepancy [unless it] had **actual knowledge**."[38] Actual knowledge is not the Texas law's standard. The standard in Texas can be characterized as "knew or should have known," so we could expect a Texas court (or arbitrators applying Texas law) to declare the "actual knowledge" standard void.

Reviewing contracts for defects and changed-condition provisions is the bread-and-butter of a general counsel's transactional work. What does the contract require? What are the risks, and how are they allocated? Do the provisions conform to the law? If a dispute arises, the general counsel will ask the same questions, but the focus will be narrowed from contract risks in general to the risks under the dispute's particular facts, the relevant contract language, and the applicable law as these play out in litigation.

The False Claims Act

Defects can lead to additional costs and compensation for those costs will often be rightfully sought by contractors through claims submitted to the project owner. A general counsel will advise against pursuing those costs carelessly, over-aggressively, or wrongfully since that can result in legal trouble with the government. The U.S. government has enacted various statutes to protect the government from unwarranted claims. The False Claims Act ("FCA")[39] is of primary concern to contractors and their counsel. Many state governments also have little False Claims Acts, which are state laws that mimic the federal statute.[40] A primary focus of these state laws (and in the case of Texas's law—its applicability) has been Medicaid claims, but most also apply to construction claims against state government agencies.[41]

The FCA operates by looking at a claim for payment, not what underlies it or whether payment was actually made.[42] Just knowingly billing for work not performed is enough to trigger FCA liability. And "billing" should be understood broadly. Submitting a "padded" extra cost

[38] EJCDC C-700 (Rev. 1), § 3.03.A.3, pp. 8-9, *Standard General Conditions of the Construction Contract*, (National Society of Professional Engineers, American Council of Engineering Companies, and American Society of Civil Engineers, 2013) (emphasis added).
[39] 31 USCS §§ 3729-3733.
[40] *See, e.g.*, 740 Ill. Comp. Stat. Ann. 175/1 (Illinois); Tex. Hum. Res. Code § 36.002.
[41] *See, e.g.*, TAF Coalition, *State False Claims Acts*, available at https://www.taf.org/resources/state-false-claims-acts/ (last visited January 9, 2024)
[42] *See United States ex rel. Wilkins v. N. Am. Constr. Corp.*, 173 F. Supp. 2d 601, 626 (S.D. Tex. 2001)

proposal or "REA" (a request for equitable adjustment) can trigger FCA liability.[43] And "knowingly" is not actual knowledge; The standard is known or should have known.[44]

A narrow focus on payment applications or proposed cost claims for FCA compliance can be a mistake. The nature of false documentation that would cause a FCA violation is much broader, and can include schedules and schedule updates. In a California case, under California's little False Claims Act[45] the government alleged the contractor "falsely represented the progress of the work … and the impact of [owner]-initiated changes to the work, [using] monthly schedules and schedule reports … to obtain additional payments for acceleration and inefficiency."[46] The court held that those allegations were sufficient to support a California False Claims Act complaint.[47] Worth noting is that California courts use federal cases to interpret the California FCA[48] and that a federal court, faced with similar allegations, also considered them sufficient, if proved, to support FCA liability.[49]

Where a court will draw the line between aggressive and fraudulent can be difficult to discern, but contractors who think they are getting close to that fuzzy grey edge would do well to have a conversation with their general counsel. Even prevailing against an alleged FCA violation can be a long and expensive process.[50]

The Concerns of the General Counsel

Taking several steps back, the broad nature of a general counsel's job has an overlooked and important feature: The general counsel's legal duty is to the company, not its employees. In fact, when corporate attorneys are doing internal investigations, they should give employees what is called an "*Upjohn*[51] warning," advising them that the attorney represents the company and not them individually. Employees should understand that any attorney client privilege

[43] *Id*. at 640.
[44] *See id*. at 638.
[45] Cal. Gov't Code § 12650 et seq.
[46] *City & Cty. of S.F. v. Tutor-Saliba Corp*., No. C 02-5286 CW, 2005 U.S. Dist. LEXIS 46590, at *35 (N.D. Cal. Mar. 17, 2005).
[47] Id.
[48] *Id*. at 32.
[49] *See Sterling Millwrights, Inc. v. United States*, 26 Cl. Ct. 49, 107, (1992) (dismissing a FCA complaint because the government did not prove the contractor "recklessly submitted … updates containing false data or that they were in reckless disregard of the truth of the information contained in their [schedules]").
[50] *See, e.g., United States ex rel. Wall v. Circle C Constr*., LLC, 868 F.3d 466, 468-6 (6th Cir. 2017) (where the contractor prevailed against a $1.6 million FCA claim, spending $468,704 in legal fees).
[51] *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

belongs to the company. Unless the communication relates to a corporate legal matter, the employee could not prevent the attorney from testifying about their conversation or otherwise revealing its contents, and similarly, the attorney could not refuse to reveal the contents of this conversation.[52]

When the communication is about a corporate legal matter, attorney client privilege exists. The employee "cannot be compelled to answer the question, 'What did you say or write to the attorney?'"[53] At the same time, just because the employee related *a fact* to her company's attorney, she cannot refuse to disclose that fact just because she told it to the company's general counsel.[54]

So, what should an employee tell her general counsel? The answer is, "Everything that is relevant to the inquiry." Counsel should recommend that facts be documented in writing and opinions discussed in person or over the phone—verbally. When an event occurs or a situation develops that could result in a dispute or litigation, contemporaneously and accurately memorializing the facts is essential to determining the company's rights and responsibilities and the best path forward. For example, if there is an accident, pictures and a report showing the facts of who, what, where, when, and how should be documented: all traffic control at and entering an accident site, the damaged vehicles (but not injured people—generally) should be photographed from multiple angles. If an employee issue arises—allegations of harassment, discrimination, wrongful discharge—a note to the file with what was said or observed and under what circumstances should be drafted as soon as the incident occurs. These contemporaneous records are essential to the general counsel's assessment of the company's legal exposure and legal options—settle and for how much or litigate.

But save the opinions and speculation for a phone conversation—not texts, not emails, and for goodness sakes, not social media.

On Behalf of General Counsels Everywhere

[52] *See, e.g.*, *Sims v. Roux Labs., Inc.*, No. 06-10454, 2007 U.S. Dist. LEXIS 65331, at 10-12 (E.D. La. Aug. 31, 2007).
[53] *Upjohn* at 396.
[54] *Id.*

There are a variety of risks associated with operating a construction company. There are defective contracts, one-sided contracts, and risks associated with statutes like the False Claims Act and with everyday occurrences on projects like personnel issues and accidents. It is the role of the general counsel to educate the executives and frontline employees about these risks, remembering that reward and risk are often linked. Employees at all levels need to take those lessons seriously. But accidents and “stuff” happen. A general counsel needs the help of all employees involved to give accurate, comprehensive, and timely information about a situation so that he or she can assess the legal ramifications, assist the company in mitigating any damage, and, if it comes to it, guide the company successfully through claims assembly and submission and, if the circumstances require, litigation.