

Key Clauses in Design and Construction Contracts for Condominium Projects

Presented to:

29th Annual Construction Law Conference
San Antonio, Texas

Presented by:

Joe R. Basham
Allensworth & Porter, LLP
100 Congress Ave. Suite 700
Austin, Texas

In 2015, the Texas Legislature amended the Uniform Condominium Act adding Sections 82.119 and 82.120 that impose conditions precedent on actions brought by condominium associations for design or construction defects. Among other things, the changes require notice and an opportunity to cure alleged defects, similar to the requirements in the Residential Construction Liability Act (RCLA).

The amendments were described as “restrict[ing] condominium unit owners’ associations in condominiums that had eight or more units from filing lawsuits or initiating arbitration proceedings to resolve a claim pertaining to the construction or design of a unit on behalf of all of the owners unless” the unit was inspected by an independent, licensed, professional engineer, and the action was approved by unit owners holding at least 50% percent of the total votes.¹

Supporters of the bill argued that demand for condominiums (and other housing units) was high, and the changes would minimize risks to developers, contractors, and design professionals, which would hopefully increase the supply of condominium projects. Opponents argued that the new restrictions would create “costly and complex barriers to justice for condominium owners.” They argued that the association would be required to jump through “numerous administrative hoops without the assistance of counsel before filing a claim.”²

While there are certainly detractors of the new provisions (which prohibit the plaintiff’s lawyer from handling the process), condominium projects having historically presented a disproportionately higher risk to the construction and design team than virtually any other type of project.

Condo Projects are Risky

There are literally hundreds of articles describing in detail the risky nature of condo projects.

*Condominiums are far and away the most liability-prone projects undertaken by design and technical consultants. While less than [1%] of the fees generated by XL Insurance policyholders come from condo projects, nearly [8%] of claims dollars paid or attributed to condo work. The frequency and severity of claims against condominium designers was (and is) so high that, for a time, almost no professional liability insurer would cover architects or engineers who design condominiums.*³

¹ House Research Organization bill analysis; HB 1455. The initial draft of the bill required 67% of unit owners to approve the action, though that was changed in the final version, which required a simple majority (50%).

² *Id.*

³ XL Group’s Contract eGuide for Design Professionals. © 2014 X.L. America, Inc.

For condos, the ratio of claim dollars to fees is a staggering 12.0. That means that for every dollar of fees earned on condos, \$12 gets paid in claims.⁴

One article estimated that in 2004, loss ratios on condo projects were anywhere from 228% to more than 900% depending on the discipline. Such high loss ratios become especially problematic for contractors and architect during periods of rapid economic expansion in which condominium projects can outpace other housing developments. Texas has been no exception to this trend.

Residential condo development is booming after years of stagnation. Downtown Austin has several high-rise condo projects in the development pipeline⁵

Houston's luxury condominium market is heating up. There are more than a dozen new condo projects planned or under construction across the Bayou City.⁶

Dallas-Fort Worth has never been known as a big condo market — and will likely never turn into a Miami — but condo prices in North Texas have risen 20 percent on average year-over-year, outpacing the appreciation of condos in any other major market in the United States, according to the latest Zillow data ... "I think condos will be built to meet some of that demand and we're going to see a pick up in condo construction," she added.⁷

With the recent influx of condominium development, together with all of the projects currently in the works, it is important for owners, contractors, and architects to understand what makes a condo project uniquely risky and to work collectively to minimize that risk.

Why are Condo Projects so Risky?

Industry experts have written substantially on the reasons why condo projects are so risky. Most articles include one or more of the following reason for the added risk:

1. Condo developers are highly-leveraged and are incentivized to cut costs at the expense of quality;

⁴ Confronting Condominium Risk; Risk Management Information from the Design Professional Group of XL Insurance.

⁵ Austin Business Journal May 13, 2015; Jan Buchholz; <http://www.bizjournals.com/austin/blog/real-estate/2015/05/condo-explosion-the-independent-unveils-latest.html>

⁶ Houston Business Journal, January 1, 2016; Paul Takahashi; <http://www.bizjournals.com/houston/print-edition/2016/01/01/developers-have-dozens-of-luxe-condo-projects.html>

⁷ Dallas Business Journal, October 29, 2015; Candace Carlisle; <http://www.bizjournals.com/dallas/news/2015/10/29/dfw-condos-appreciating-faster-than-single-family.html>

2. Architects are not hired to provide construction administration services (construction observations), or are only hired to produce a “builder set” of drawings – just sufficient to get a building permit;⁸
3. Unit buyers have unrealistic expectations.
4. Unit buyers *actually* believe the advertisements, promotional materials and marketing tactics prepared by the Developer or its sales team.
 - a. Notice this disclaimer on the website of a certain condo project: *The developers reserve the right to make modifications and changes to the information contained herein. Renderings, photos and sketches are representational and may not be totally accurate. Dimensions, sizes, specifications, layouts, views and materials are approximate and subject to change without notice.*
5. Unit buyers of “high-end” units have unreasonable expectations of the quality of the finished product.
6. The tight labor market results in un-skilled or under-skilled workers actually performing the work, and difficult, unique, or unusual design elements are not fully understood or properly implemented;
7. The Association is unwilling to set realistic fees to cover proper maintenance, which results in a lack of maintenance or inadequate maintenance;
8. Condo projects allow for the repetitive implementation of errors. One error on the plans, or one misunderstanding by the contractor, gets repeated hundreds or possibly thousands of times;
9. The developer is often a “shell” company that is not likely to stick around for the long-haul, or care much about its reputation; and
10. The developer, architect, or contractor lacks experience with condominium projects.

Stealth Condos

These risks, and numerous horror stories, prompted many in the industry to avoid condo projects at any cost. As a result, some developers chose to create what have been called “stealth condos,” which is a project that is originally planned as apartments, but at some point during construction, or after completion, is converted to condominiums.

The contractor or architect’s inability to make appropriate revisions to accommodate a condo project (e.g., addressing acoustical, mechanical, or code issues) make stealth condo projects particularly problematic. Once the project is underway, the contractor and architect may exercise little control over the project’s development. A further complication is that the existing contract probably does not provide a clear option for a contractor or architect’s termination; typically, it will only allow the contractor or architect to terminate if the owner has failed to pay, or the project has been seriously delayed. Owners argue that the practical effect of converting from apartments to condos is minor and that such “minor” changes can be accomplished through a Change Directive.

⁸ The Texas Board of Architectural Examiners has taken the position that “builder set” drawings may not be used for construction.

Due to these problems, the increase in stealth condos has raised alarm bells across the industry:

There has been an increased incidence of conversions of rental apartment units to condominium ownership. This has been caused in part by the glut of construction prior to the economic collapse and the ensuing difficulty in maintaining profitable rentals in a down economy. Add to that the scope and quality variations caused by contractor and owner value engineering substitutions, and the fact that the ultimate third-party condo owners are not always happy with the finished product.⁹

Many professional liability carriers have been instructing their insureds to include clauses prohibiting the condominium conversions. The AIA is also aware of those concerns, and the relatively new AIA B109 – 2010 now includes a provision stating that: “Owner has represented that the Project shall not include a residential condominium.”

Although not all condominium conversions end up in disputes, withholding information from the contractor and architect to avoid paying the risk-premium associated with condo projects significantly impairs the parties’ collaborative efforts to draft the contracts used on condo projects.

These risks makes developing condo projects difficult, which in turn hampered the ability of developers and by extension, municipalities and other governmental entities to bring more (and ideally, affordable) housing units online. As a result, industry groups sought more protections from the legislature. Those efforts ultimately resulted in the addition of Sections 82.119 and 82.120 of the Uniform Condominium Act.

TEXAS PROPERTY CODE §§ 82.119 AND 82.120 (UNIFORM CONDOMINIUM ACT)

The primary protections offered by the new provisions are pre-suit notice, inspection rights, the right to cure, and the requirement for at least 50% approval by the unit owners before an action can be initiated.

Pre-suit Requirements

Prior to filing suit (or initiating an arbitration) “pertaining to the construction or design” of a unit or common element, a condominium association with eight or more units must obtain an inspection and report from a licensed professional engineer.

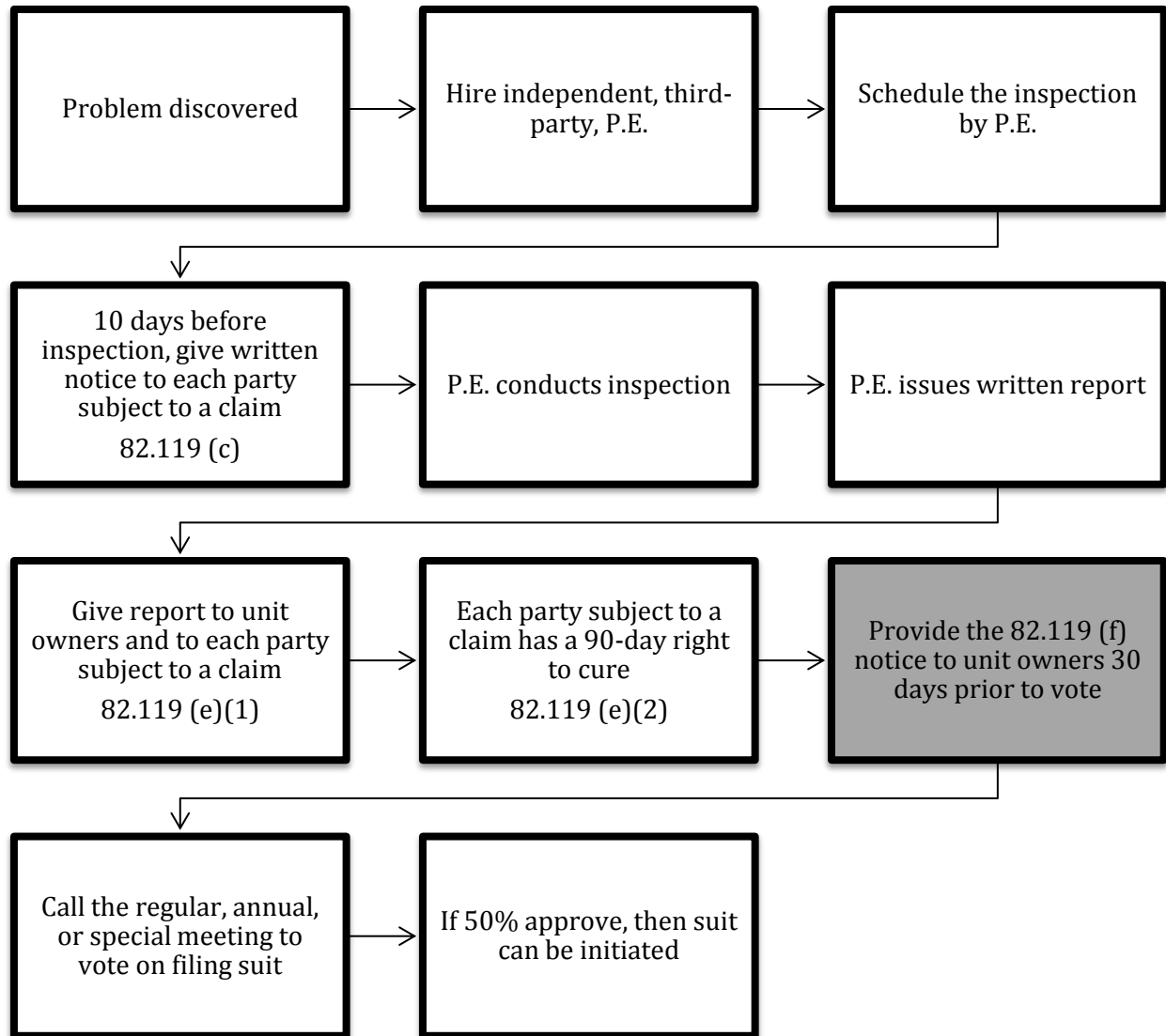
That report must:

1. Identify the specific units or common elements subject to the claim;
2. Describe the present physical condition of the units or common elements subject to the claim; and

⁹ AIA Trust – Professional Liability Insurance Carrier Annual Interviews – 2014;
<http://www.theaiatrust.com/filecabinet/PLI-Interview-Summary-2015.pdf>

- Describe any modifications, maintenance, or repairs to the units or common elements performed by the unit owners or the association.

Once the engineer’s report is completed, the association must provide a copy of the report to the unit owners and to “each party subject to a claim.” Before an action can be initiated, the association must obtain approval from the unit owners holding more than 50% of the total votes. The condo association must complete other steps along the way, as the flowchart below illustrates.



The association’s pre-inspection notice must:

- identify the engineer;
- identify the specific units or common elements to be inspected; and
- state the date and time of the inspection.

Representatives for “each party subject to a claim” (e.g. the contractor, architect, and their “agents”) may attend the inspection.

Once the engineer has completed the report, the report must be given to the unit owners and to each party subject to a claim. The completion of the report triggers a 90-day cure period during which each party may “inspect and correct any condition identified in the report.”¹⁰

Assuming the contractor and architect have not cured the alleged defects, or if the parties cannot agree on the appropriate repair, the association must send a detailed notice to the unit owners for approval to file suit. Under §82.119, the association must get 50% of the total votes allocated under the condominium association’s declarations to initiate arbitration or file suit.

The notice to the unit owners must identify the meeting date, time, and location and include the following:

1. a description of the nature of the claim, the relief sought, the anticipated duration of prosecuting the claim, and the likelihood of success;
2. a copy of the engineer’s report;
3. a copy of the contract or proposed contract between the association and the attorney selected by the board to assert or provide assistance with the claim;
4. a summary of the steps previously taken by the association to resolve the claim;
5. a statement that initiating the lawsuit or arbitration proceeding to resolve a claim may affect the market value, marketability, or refinancing of the unit while the claim is prosecuted; and
6. a description of the manner in which the association proposes to fund the cost of prosecuting the claim.

Section 82.119(f) prevents anyone from the association’s law firm from preparing the notice. Specifically, the notice cannot be prepared or signed by:

1. the attorney who represents or will represent the association in the claim;
2. a member of the law firm or the attorney who represents or will represent the association in the claim; or
3. an employee or affiliate of the law firm of the attorney who represents or will represent the association in the claim.

In response to concerns that these new requirements and deadlines could prevent the filing of an action within the statute of limitations, §82.119 (h) was added to toll the statute of limitations if the procedures are initiated in the final year of the applicable statute of limitations.

§ 82.119 (h) The period of limitations for filing a suit or initiating an arbitration proceeding for a claim described by Subsection (b) is tolled until the first anniversary of the date the procedures are initiated by the association under that subsection if the procedures are initiated during the final year of the applicable period of limitation.

¹⁰ TEX. PROP. CODE § 82.119 (e)(2).

Section 82.119 (h) might apply to the statute of repose, which already provides for a two-year extension when a written claim is presented within the repose period, although that is not totally clear. The Texas Supreme Court, in *Galbraith Engineering*, held that “the term ‘limitations’ ... refer[s] only to statute of limitations [and not statutes of repose].”¹¹

Section 82.120 authorizes condominium declarations to mandate binding arbitration for the resolution of construction defect and design claims. It also limits the ability to amend the condominium declaration to remove any such mandatory arbitration requirement “after-the-fact” for claims based upon acts or omissions that occurred prior to the amendment.

§ 82.120. BINDING ARBITRATION FOR CERTAIN CLAIMS.

(a) A declaration may provide that a claim pertaining to the construction or design of a unit or the common elements must be resolved by binding arbitration and may provide for a process by which the claim is resolved.

(b) An amendment to the declaration that modifies or removes the arbitration requirement or the process associated with resolution of a claim **may not apply retroactively to a claim regarding the construction or design of units or common elements based on an alleged act or omission that occurred before the date of the amendment.** (emphasis added).

Residential Construction Liability Act (RCLA)

The RCLA applies to “a unit and the common elements in a multiunit residential structure in which title to the individual units is transferred to the owners under a condominium or cooperative system.”¹² The RCLA has similar provisions governing notice, and the opportunity to cure, however it is limited to the “Contractor” which includes the “person contracting with an owner or the developer of a condominium for the construction of a new residence.”¹³ It does not, by its plain terms, include the architect, engineer, or any consultants.

The RCLA differs from §82.119 in that the notice and cure provisions allows the Contractor to make a “written offer of settlement to the claimant.”¹⁴ If the claimant rejects a reasonable offer made under RCLA, then the claimant may not recover an amount in excess of:

1. the fair market value of the contractor’s last offer of settlement under Subsection (b);
or
2. the amount of a reasonable monetary settlement or purchase offer made under Subsection (n).

¹¹ *Galbraith Engineering Consultants, Inc. v. Pochucha*, 290 S.W. 3d 863 (Tex. 2009).

¹² TEX. PROP. CODE § 27.001 (7).

¹³ TEX. PROP. CODE § 27.001 (5) (A) (iii).

¹⁴ TEX. PROP. CODE § 27.004 (b).

The Claimant's recovery is also limited to:

the amount of reasonable and necessary costs and attorney's fees as prescribed by Rule 1.04 of the Texas Disciplinary Rules of Professional Conduct, incurred before the offer was rejected or considered rejected.

Be aware that RCLA includes the following provision:

Except as provided by this subsection, **to the extent of conflict between this chapter and any other law**, including the [DTPA] or a common law cause of action, this chapter prevails.¹⁵

It is not clear whether §82.119 actually conflicts with the RCLA, but if it does, the RCLA would presumably govern. For example, the RCLA gives the contractor 45 days after it receives the RCLA notice to make a written offer of settlement, which may include an offer to repair the alleged defect. The contractor then has 45 days after the owner accepts the offer to complete the repairs. These deadlines may not line up with the deadlines in §82.119, but since the deadlines in the RCLA are not mandatory (the contractor can choose to ignore them) there is not a direct conflict. However, contractors and architects should be aware that even though §82.119 gives them 90 days after receipt of the engineer's report to inspect and correct any condition identified, they may have 45 days under the RCLA to take advantage of the statutory cap on damages.

CONTRACT CONSIDERATIONS

The AIA and other organizations have spent considerable time suggesting changes to standard contracts for condominium projects. One of the issues, however, is that the contractor or architect may have little to no input on the condominium documents (e.g. the purchase agreement or the declarations), which can be, in many ways, more important. The design and construction contracts need to be coordinated, not only with each other, but also with the condominium documents, specifically the purchase agreement and condominium declarations.

Architects should consider starting with the AIA B109–2010 Standard Form of Agreement for a Multi-Family Residential or Mixed Use Residential Project. The B109–2010 is based on AIA Document B103–2007, Standard Form of Agreement Between Owner and Architect for a Large or Complex Project. It uses the traditional division of services, dividing them into Basic and Additional Services, and adds a new Pre-Design Services that allows the parties to consider project feasibility, layout, and regulatory requirements.

Note that the standard B109 contains the following clause that must be revised when the project is intended as residential condos:

¹⁵ TEX. PROP. CODE § 27.002 (b) (emphasis added).

§ 2.3 Unless otherwise indicated in the Initial Information, the Owner has represented that the Project shall not include residential condominium. The Architect shall provide services based on the Owner's representation of the intended usage and ownership of the Property.

The AIA B109 is particularly useful for condo projects because it prompts the owner to list the following consultants the owner will hire:

- Cost Consultant,
- Scheduling Consultant,
- Geotechnical Engineer,
- Civil Engineer, and
- Building Envelope Consultant.

Regardless of whether the owner or the architect hires a building envelope consultant, it is important that the parties consider this vital consultant. If the owner is unwilling to hire, or pay for, a building envelope consultant, the architect should seriously consider whether it wants to be associated with the project. Owners and architects should also discuss the hiring of an acoustical consultant as another common complaint on condo projects are noise issues.

The AIA does not have a construction contract geared specifically toward condo projects, so the parties will need to select a form based upon the project delivery method: lump sum (A101); cost plus a fee (A102); construction manager at risk (including pre-construction services) (A133).

From the owner's perspective, the architectural and construction contracts must be coordinated. Many owners execute letter agreements with architects that do not describe a dispute resolution process. When the owner later signs the construction contract, that agreement may require arbitration. If the owner fails to obtain the architect's agreement to arbitrate, the owner will be forced to have a fractured dispute resolution process.

Insurance

Proper risk management necessarily includes a discussion about insurance, particularly for condos. A detailed discussion of insurance issues, however, is beyond the scope of this paper.

Numerous projects are constructed using the traditional method where the contractor purchases a general liability policy, the architect is required to maintain its professional liability policy, and either the owner or the contractor to purchases the builder's risk insurance. The downside to this method is the very real potential for gaps in coverage, or the uncertainty of devastating exclusions, like those listed below:¹⁶

¹⁶ IRMI; Construction Defect Crisis Produces Coverage-Restricting Endorsements; Ann Hickman, August 2003. <http://www.irmi.com/articles/expert-commentary/construction-defect-crisis-produces-coverage-restricting-endorsements>

COMMON EXCLUSIONARY ENDORSEMENTS	
Known or Continuous Injury or Damage	Prevents policies from being triggered with regard to losses of which the insured is aware prior to the policy inception date.
EIFS Exclusion	Removes coverage for injury or damage connected in any way to the presence of an EIFS on the building.
Mold Exclusion	Removes virtually all coverage for claims arising out of exposure to or inhalation of fungi, which includes all varieties of mold and bacteria.
Earth Movement Exclusion	Removes coverage for injury or damage that is wholly or partially caused by virtually all types of earth or land movement.
Residential Construction Exclusion	Removes coverage with respect to any operations in connection with property intended for habitation. Some of these endorsements apply only to multifamily housing, such as apartments, town homes, and condominiums.
Damage to Work Performed by Subcontractors on Your Behalf (CG 22 94 and CG 22 95)	Eliminates coverage for damage to "your work" arising out of subcontractors' work, and damage to the named insured's work that is caused by a subcontractor's work.
Contractors Limitation Endorsement	Adds a combination of the above exclusions, as well as others not related to construction defects, to the umbrella policy.

Because of these downsides, more projects are being insured under a controlled insurance product (wrap policy). Whether the policy is owner-controlled (OCIP) or contractor-controlled (CCIP), a wrap policy require specialized knowledge, and a high level of administration.

Note that even if a wrap policy is purchased, the architect and its consultants will need to purchase their own professional liability insurance. Although some suggest that professional liability can be included in the wrap policy, those policies likely only provide bodily injury and property damage coverage, and not coverage for the typical design deficiency allegation. The best practice is to confirm with an insurance specialist that the policy will provide the coverage needed for the particular project.

Owners often want architects to purchase a project-specific policy, rather than relying on the architect’s practice policy. Project-specific policies are very useful on condo projects, but are also very expensive, especially considering that the policy is written on a “claims-made” basis,

which requires maintenance of the policy for the full 10-year Statute of Repose period. The cost of a project-specific policy is often more than an owner is willing to pay, but the benefit is that any claims made on the architect's practice policy will not erode the coverage available on the condo project.

RELYING ON THE CONDO DOCUMENTS

The primary issue on any condominium project—from a legal perspective—is the lack of contractual privity with the association or unit owners. Contractors and architects alike may spend thousands of dollars negotiating the terms of their contract with the owner, but those clauses may be of little to no use in claims asserted by a contractual stranger.

To have any real protections against claims brought by the association or unit owners, it is important to have some ability to rely on the provision in the purchase agreement and condominium declarations. If the owner is sophisticated, and has experienced counsel familiar with condominium documents, those protections can be very valuable. Below are several clauses that contractors and architects (or their counsel) should look for in the condominium documents.

Each unit owner will sign a purchase agreement when they buy a unit. This is the first line of defense to claims by unit owners against the contractor and architect.

Because the RCLA applies, the purchase agreement must include the RCLA disclaimer language:

This contract is subject to Chapter 27 of the Texas Property Code. The provisions of that chapter may affect your right to recover damages arising from a construction defect. If you have a complaint concerning a construction defect and that defect has not been corrected as may be required by law or by contract, you must provide the notice required by Chapter 27 of the Texas Property Code to the contractor by certified mail, return receipt requested, not later than the 60th day before the date you file suit to recover damages in a court of law or initiate arbitration. The notice must refer to Chapter 27 of the Texas Property Code and must describe the construction defect. If requested by the contractor, you must provide the contractor an opportunity to inspect and cure the defect as provided by Section 27.004 of the Texas Property Code.¹⁷

The purchase agreement should include an *as-is, where is* clause:

Except as provided elsewhere, Seller makes no representations or warranties in connection with the property, and Purchaser agrees that Purchaser is acquiring the Property *as is and where is*.

¹⁷ TEX. PROP. CODE §27.007.

It is important for the purchase agreement and declarations to require the buyer to perform a pre-closing inspection of the unit. This inspection process should be coordinated with the scope and terms of the limited warranty. Some projects simply assign the contractor's warranty obligations to the unit buyers at the time of closing. For this reason, it is important for the contractor to understand its warranty obligations are being assigned directly to the buyers, and to coordinate the inspection (punchlist) process so that it clearly understands its obligations. Contractors will want to ensure that the buyers have a narrow window of time to report obvious warranty issues, so that the responsible subcontractor can be notified, and the work scheduled. The contractor and its subcontractors will want to coordinate the warranty (punchlist) work so that they are not making numerous trips back to the project.

The contractor will want to pay particular attention to its one-year warranty (correction period) in the construction contract, since this obligation will likely be similarly assigned to the association and unit buyers. Care must be taken that the timing of the one-year warranty is the same in both the construction contract and the purchase agreement or declarations, so there are no disagreements on how long the contractor must keep coming back to the project to correct warranty items.

Contractors and architects will both want to confirm that the purchase agreement and declarations include disclaimers of warranties, like merchantability, and fitness for a particular purpose.

Dispute Resolution

Because the dispute resolution procedure outlined in the condominium declarations are likely to be beneficial to the contractor and architect, it is important that those procedures are clearly conveyed to the unit owner prior to closing:

PURCHASER ACKNOWLEDGES AND AGREES THAT ANY CLAIM OR DISPUTE ARISING OUT OF OR RELATING TO THE DESIGN OR CONSTRUCTION OF THE PROJECT, INCLUDING WARRANTY CLAIMS, SHALL BE RESOLVED IN ACCORDANCE WITH THE DISPUTE RESOLUTION PROCEDURES DESCRIBED IN THE DECLARATIONS. PURCHASER UNDERSTANDS THIS IS A MATERIAL INDUCEMENT TO SELLER'S ENTERING THIS CONTRACT, AND SELLER WOULD NOT HAVE ENTERED INTO THIS CONTRACT AT THE PRICE STATED WITHOUT SUCH AGREEMENT.

The dispute resolution procedure provided in the declarations will likely require mediation as a condition precedent to bringing an action, and then binding arbitration. To have some ability to prevent the association or unit owners from avoiding these requirements, and filing suit directly against the contractor or architect, the contractor and architect should have some ability to enforce the dispute resolution procedures in the declarations. We have, in some instances, requested that the contractor and architect be named as an intended third-party beneficiary in the declarations. Alternatively, contractors and architects should request that the

owner agree to assign the owner's rights to the contractor and architect, for the express purpose of enforcing the dispute resolution procedures. For example:

Declarant may assign its rights and obligations pursuant to this Dispute Resolution Provision, unilaterally and in whole or in part, to one or more third parties participating in construction of the improvements in the Project (including without limitation, the contractor and architect).

The usefulness of this provision depends, obviously, on the owner (declarant) actually being around at the time of the dispute, and its willingness to actually assign those rights to the contractor or architect in the event a unit owner attempts to circumvent the dispute resolution procedures.

Contractors and architects will want to ensure that the dispute resolution procedures outlined in the declarations: (1) specifically include claims relating to the design, construction, or maintenance of the units; (2) that claims arising out of the design or construction of the condo are subject to a mandatory mediation; and (3) if not resolved in mediation, then binding arbitration.

Well-drafted condominium declarations will include a shortened statute of limitations period (typically 2 years and 1 day), barring claims that have not been asserted in that time period. While a shortened limitations period can be useful, it may not provide an absolute defense to claims asserted after that time period. A shortened limitations period must comply with Texas Civil Practices and Remedies Code §16.070(a), which says:

(a) Except as provided by Subsection (b), a person may not enter a stipulation, contract, or agreement that purports to limit the time in which to bring suit on the stipulation, contract, or agreement to a period shorter than two years. A stipulation, contract, or agreement that establishes a limitations period that is shorter than two years is void in this state.

Whether the shortened limitations period is enforceable will depend on when the plaintiff's cause of action accrued. "A cause of action generally accrues at the time when facts come into existence which authorize a claimant to seek a judicial remedy."¹⁸ If the accrual of the cause of action occurs after the date stipulated in the contract, it will "result in a 'time in which to bring suit' that is shorter than two years in violation of section 16.070(a) of the civil practices and remedies code."¹⁹

In reviewing the condominium documents, the contractor and architect will want to confirm that it will require at least a simple majority, but ideally, a super-majority, vote of the owners before the association can bring a claim. For example:

¹⁸ *Murray v. San Jacinto Agency, Inc.*, 800 S.W. 2d 826, 828 (Tex. 1990).

¹⁹ *Spicewood Summit Office Condos Ass'n, Inc. v. Am. First Lloyd's Ins. Co.*, 287 S.W.3d 461 (Tex. App.—Austin 2009, pet denied).

The Association may not initiate any judicial or administrative proceeding without the prior approval of Owners of at least 75% of the Units.

The condominium declarations should also clearly require the association to levy a special assessment to fund any proposed litigation or arbitration, and preclude the association from simply using its operating income or reserves to pay for the litigation or arbitration. The reason for this is straightforward: the unit owners should have *informed consent* as to the cost of the litigation prior to bringing the action, and should not put off other maintenance and other obligations in order to fund the litigation.

Many of these suggested clauses are similar to what is now required by the new sections 82.119 and 82.120, but these statutory requirements are only the minimums. Nothing prevents the condominium declarations from requiring more. Section 82.119 (b) says: “In addition to any preconditions to filing suit or initiating an arbitration proceeding included in the declaration” In other words, just because Chapter 82 says that the association must obtain at least 50% approval to proceed with litigation does not mean that the declarations cannot require 75% or more.

SUGGESTED CONTRACT CLAUSES

Because the condominium documents are likely not drafted at the time the construction contract or architectural agreement are negotiated, contractors and architects should consider requiring those clauses be part of the condominium declarations, by getting the owner’s agreement in advance.

Below is a sample provision in an owner-architect agreement,

REQUIRED CONTRACT CLAUSES

The Owner shall include the following in the Purchase Agreement with Unit Owner(s) and in the Condominium Declaration:

- .1 The HOA and/or Unit Buyers will obtain and maintain property insurance required by § 82.111, Subchapter C, Chapter 82 of the Texas Property Code on completed units and common areas and will provide waiver of subrogation to Owner, Architect and Contractor for damages and/or losses covered by such property insurance;
- .2 The approval of Unit Owners holding at least 67% of the total votes allocated under the Condominium Declaration must be obtained by the HOA prior to initiating a suit or arbitration to resolve a claim pertaining to the construction or design of a Unit or the common elements;
- .3 HOA is given authority to pursue and resolve all claims affecting the common elements on behalf of Unit Buyers and Unit Buyers will be bound by such resolution;
- .4 Waiver of consequential damages against Owner, Architect, and Contractor;
- .5 HOA will enter into customary property management and/or maintenance contracts for administration of the HOA and the portions of the regime to which the HOA is obligated to maintain;

Architects often negotiate a limitation of liability clause in the agreement with the owner. Whether that clause limits the architect’s liability to its fee, some specific amount, or the amount

of insurance carried by the architect depends on the owner, the type of project, and the level of service provided by the architect. For instance, if the owner does not intend to hire the architect to provide full contract administration (construction observations), architects may lower the amount of the limitation of liability in recognition of the greater risk. If there is a limitation of liability clause in the owner/architect agreement, then architects should request that the limitation be carried over into the condo docs as an additional required clause:

- .6 The aggregate liability of the Architect and any of the Architect's consultants for any actions, damages, claims, demands, judgments, losses, costs, or expenses arising out of or resulting from the Architect's or its consultants' negligent acts, errors, or omissions is limited to the [insert amount of limitation].

Contractors and architects should also have the owner commit to requiring mediation and arbitration in the condominium documents.

MEDIATION AND ARBITRATION

In addition to the requirements stated herein, the parties acknowledge that disputes brought by the HOA pertaining to the construction or design of a Unit or the common elements are subject to Subchapter C, Chapter 82 of the Texas Property Code, specifically §§82.119 – 82.120. The Owner shall include in the Condominium Declaration a requirement that any dispute brought by the HOA or Unit Owners pertaining to the construction or design of a Unit or the common elements shall be first submitted to mediation in accordance with the American Arbitration Association's Construction Industry Rules, current edition. Any dispute not resolved through mediation shall be submitted to binding arbitration in accordance with such rules. Any award rendered by the arbitrator(s) shall be final, and judgment may be entered upon it in accordance with applicable law in any court having jurisdiction thereof. The arbitrator's findings of fact shall be final in any such appeal.

As mentioned above, the contractor and architect will want the ability to enforce various requirements in the condominium documents, like the dispute resolution procedure. This may be accomplished by naming the contractor and architect as intended third-party beneficiaries, or by giving the developer/declarant the right to assign certain rights and obligations under the declarations to third parties, including the contractor and architect. Either way, there should be some reference to the construction team's ability to enforce the dispute resolution procedures outlined in the purchase agreement condominium declarations.

The Owner agrees that the Condominium Declaration will provide that the [Contractor or Architect] can enforce the dispute resolution provisions and any provisions limiting the time during which actions claiming construction or design defects or maintenance obligations may be brought or maintained.

Notice and opportunity to cure

The amendments to the Uniform Condominium Act now require notice and opportunity to cure. The RCLA also has notice and cure rights, but architects are not specifically included in RCLA. Accordingly, owner/architect agreements should contain the following:

The Parties agree that Texas Property Code Chapter 27 (Residential Construction Liability Act) shall apply equally to this Agreement and shall set out Owner's remedies for design defects. The term "Contractor" as used in RCLA shall be deemed to equally apply to Architect.

The Owner will promptly notify Architect of any claims made by the HOA and/or the Unit Owners relating to defective design or construction. The Condominium Declaration will provide the Architect with the right to inspect and correct any design defect pertaining to a Unit or common elements which is the basis for a claim brought by the Unit Owners. The parties acknowledge that §82.119 of Subchapter C, Chapter 82 of the Texas Property Code allows each party subject to a claim brought by the HOA at least 90 days to inspect and correct any condition identified in the report regarding such section.

Maintenance Manual

Nearly all literature discussing condominium liability points out the need for proper maintenance. Our experience is that well-financed developers building “luxury” condominiums will typically have well-drafted condominium documents that include detailed requirements for maintenance of both the common elements and the individual units. However, we still recommend including a requirement in the contract with the owner/developer for the provision of maintenance, such as:

The Owner agrees that the Condominium Declaration will require that the HOA perform inspections and maintenance requirements included within a maintenance manual provided by the Owner to the HOA. The Architect shall have no responsibility for the inspection, maintenance, and normal repair of any portion of the Project and shall have no financial or other responsibility for damages arising out of the failure to inspect, maintain or repair the Project.

Prohibiting conversion

When the project is planned as apartments, and specifically not as condominiums, contractors and architects should consider including specific prohibitions on later conversions.

In consideration of Contractor’s agreement to not require Owner to pay Contractor a condominium premium in the amount of [\$xxx,xxx] and to charge Owner less for this Project than Contractor would have charged in the absence of such agreement, Owner agrees to fully execute, and deliver to Contractor the PROHIBITION AGAINST CONDOMINIUM CONVERSION AGREEMENT attached as Exhibit [X] (the “Condominium Prohibition”). The fully executed Condominium Prohibition shall be provided to Contractor. Delivery of such original documents from Owner to Contractor is a condition precedent to Contractor’s commencement and continuation of the Work. Additionally, in the event Owner or other parties bound by the Condominium Prohibition elect, prior to the expiration of the Term, to convert the Project, or a portion thereof, to condominiums, Owner or such other parties shall cause the Covenant for Arbitration of Disputes attached hereto as Exhibit [X] to be included among the documents filed in the real property records in connection with the creation of such condominiums.

An example of the proposed exhibit prohibiting the conversion to condominiums is attached as an exhibit.

If the architect utilizes an AIA B109, the standard language will include a representation by the owner that the project will not be used for residential condominiums. However, this standard language should be modified similar to the language provided above to fully convey the parties' intent regarding condominium conversion.

CONCLUSION

Condominium projects are complicated and risky. These risks can be managed if the parties are willing to collaborate on the scope and details of the project, and the terms in the contracts, including specifically the condominium documents. The recent changes to the Uniform Condominium Act, specifically the addition of Sections 82.119 and 82.120 should help reduce frivolous claims and encourage prompt resolution of construction claims defect claims.

The new provisions require notice of the alleged defects, and for the association to hire a licensed, third-party, professional engineer to analyze those issues. The contractor and architect will be able to participate in the investigation, and are entitled to a copy of the engineer's report explaining the alleged problems, as well as any modifications, maintenance, or repairs performed by the unit owners or the association. Under the new provisions, contractors and architects are allowed 90 days to inspect and correct any condition identified in the engineer's report.

Afterwards, the association must provide each unit owner with a copy of the report, along with: (a) a description of the nature of the claim; (b) a copy of the proposed contract with attorney selected by the board; (c) a description of the attorneys' fees, consultant fees, and expert witness fees; (d) a summary of the previous steps taken to resolve the claim; (e) a statement describing how the claim will affect the market value, marketability, or refinancing of a unit; and (f) how the association intends to pay for the prosecuting of the claim. This information must be prepared by someone other than the association's law firm, or an employee or affiliate of the law firm.

Under §82.120, the association can no longer change the arbitration provisions in the condominium declaration, retroactively. If the condominium declarations require mandatory arbitration of construction defects or design errors, the claims will be resolve in arbitration, unless declaration is changed before the claim arises.

Contractors and architects should modify their contracts with owners to take advantage of the dispute resolution procedures outlined in the condominium declarations, and should be active participants in the drafting of the purchase agreement, limited warranty, and should carefully review any promotional materials prepared by the owner.

The parties should anticipate the types of projects that are susceptible to conversion to condominiums, and negotiate prohibitions against condo conversions.