NO. 06-0243

IN THE SUPREME COURT OF TEXAS

SOLAR APPLICATIONS ENGINEERING, INC.,
Petitioner,

v.

T.A. OPERATING CORPORATION,
Respondent.

On Petition for Review from the
Fourth Court of Appeals at San Antonio, Texas

PETITION FOR REVIEW

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STATEMENT OF THE CASE

Nature of the Case and Parties:	Suit between general contractor, Solar Applications Engineering, Inc., and owner, T.A. Operating Corporation, arising out of contract to construct $4-million truck stop. Solar sued for the unpaid balance under the contract. TA counterclaimed for alleged delays and defective work.
Trial Court:	The Honorable Patrick J. Boone, 57th Judicial District, Bexar County, Texas
Trial Court's Disposition:	Judgment rendered on jury verdict in favor of Solar for $392,000, plus attorneys' fees and costs; take-nothing judgment rendered against TA. (App. 1, 2)
Court of Appeals:	Fourth Court of Appeals; Justice Stone, joined by Justices Angelini and Marion.
Court of Appeals' Disposition:	After initially affirming judgment in favor of Solar, on rehearing reversed and rendered judgment that Solar take nothing. *T.A. Operating Corporation v. Solar Applications Engineering, Inc.*, No. 04-04-00180-CV 2005 WL 2401879 (Tex. App.—San Antonio Sept. 28, 2005, pet. filed) (App. 3).

STATEMENT OF JURISDICTION

The Supreme Court has jurisdiction of this case under Government Code section 22.001(a)(6), because this case presents an important issue of first impression involving the interpretation of contract provisions that are widely employed throughout the construction industry.

ISSUE PRESENTED

Is a general contractor who has substantially performed a construction contract required to provide lien releases from it and its subcontractors as a condition to sue an owner who has refused to pay for work done?

TO THE HONORABLE SUPREME COURT OF TEXAS:

This case presents a legal issue of first impression that implicates the lien rights of general contractors, subcontractors, and material and equipment suppliers. Because it is of substantial practical importance to the construction industry, this Court should grant review.

STATEMENT OF FACTS

Solar, as general contractor, and TA, as owner, executed a contract for the construction of a $4-million truck stop in May 1999. RR 2/36, 9/167; PX 1. TA certified Solar's substantial completion of the project as of August 11, 2000, after the City of San Antonio issued a Temporary Certificate of Occupancy. DX 6; RR5/63. TA took control of the building at that time. RR5/152. Several weeks later, TA presented a "punch list"of items that it contended needed to be done to finally complete the project. RR 3/127; PX 32. By late September, Solar had completed most of the items that were its responsibility, and was working on completing the rest. PX 19.

On November 13, 2000, TA notified Solar that it was terminating the contract "for cause," and alleged that it had suffered damages due to purported delays and defects in construction, that exceeded the amount of the contract balance. DX 12. That same day, Solar notified TA that only two minor punch list items remained to be completed, and demanded payment for the contract balance. DX 13.

Solar filed suit against TA for the unpaid balance of the contract it had substantially performed. CR 1, 122. TA filed a counterclaim. CR 7. Various subcontractors filed lien claims totaling $246,000. DX 9, 38-45. The trial court severed the lien claims, with an order

providing that any damages recovered by Solar in the main action (except for attorney's fees and costs) "be held in trust" and withheld from distribution to Solar pending resolution of the lienholders' claims in the severed action. CR 106; App. 5.

TA never disputed that Solar substantially performed under the contract. The jury found that the balance due Solar under the contract was $400,000, and the total cost to remedy all defects was $8,000. Supp CR dtd July 29, 2004 at 36, 41-42; App. 2, Question Nos. 1, 2. The jury further found that Solar failed to complete the work under the contract within the time specified by the contract, but that the delay was excused by waiver. *Id.*, Question Nos. 5, 6. Other than the $8,000 offset, the jury awarded TA no damages on its remaining claims. *Id.*, Question Nos. 3, 4, 8.

The trial court rendered judgment awarding Solar $392,000, plus attorneys' fees and costs, and awarding TA nothing. Supp CR dtd May 25, 2004; App. 1. On appeal, the court of appeals initially affirmed the judgment. *See* Ct. App. Op. 3/30/05. However, on rehearing, the court of appeals reversed itself and rendered judgment that Solar take nothing, and that TA recover $8,000. App. 3.

SUMMARY OF THE ARGUMENT

Even though Solar, as general contractor, completed all but $8,000 worth of work under a $4-million construction contract, the court of appeals held that Solar forfeited its right to recover the contract net balance of $392,000. The court reached this result through an unprecedented holding: that Solar had violated an "express condition precedent" by failing to

tender releases not only of its own mechanic's lien, but also those of its subcontractors, at a time when the owner was refusing to pay any portion of the remaining contract balance.

The parties' standard form contract involved provisions of a type that are widely used in the construction industry. When the entire contract is construed in context, it is evident that the lien-release "condition precedent" was never triggered—the owner, TA, unilaterally terminated the contract before Solar was called upon to tender lien releases as part of its formal application for final payment. This construction is consistent with holdings that contracts should be construed in a manner that preserves the statutory lien rights of general contractors and subcontractors, and construed to avoid the kind of forfeiture effected by the court of appeals' decision. Moreover, the court of appeals' expressed concern about the owner being subject to "double liability" absent enforcement of the "condition precedent" is a red herring. The manner in which the trial court structured the litigation cured the "double liability" concern.

ARGUMENT

I. This Court should grant review because this case presents an issue of first impression of substantial importance in the construction industry.

This case presents a typical conflict in the construction industry: a general contractor substantially performs under a building contract, but the owner refuses to pay the contract balance, claiming that damages allegedly due the owner for defects in construction exceed the unpaid balance. Such cases frequently result in litigation, with both parties suing for breach. This pattern is seen repeatedly in decisions by this Court stretching back more than a century. *See, e.g., Linch v. Paris Lumber & Grain Elevator Co.*, 80 Tex. 23, 35-37, 15 S.W. 208,

212-213 (1891); *Atkinson v. Jackson Bros.*, 270 S.W. 848, 850-851 (Tex. Comm'n App.1925, holding appr'd); *Vance v. My Apartment Steak House of San Antonio, Inc.*, 677 S.W.2d 480, 481-82 (Tex.1984); *Mancorp, Inc. v. Culpepper,* 802 S.W.2d 226, 227 (Tex. 1990).

The fact pattern of this case is utterly ordinary. What makes it extraordinary—and extraordinarily worrisome to both general contractors and subcontractors—is the court of appeals' unprecedented holding that a general contractor that substantially performed under a construction contract forfeited its right to recover the contract balance by failing to tender releases of its lien and the liens of all its subcontractors at a time when the owner was refusing to pay any portion of the remaining contract balance. This type of construction litigation, where both sides are suing for breach, is when the statutory protections afforded by mechanic's liens under the Texas Property Code are needed most. *See* TEX. PROP. CODE §§ 53.021, .023. To hold that the general contractor and subcontractors must *release* their statutory liens at the very inception of hotly disputed litigation, or forfeit their right to ultimately recover from the owner the balance due under the contract, is at odds with the very protections afforded by the lien statutes. This result cannot be squared with the contract.

This Court's resolution of the contractual dispute in this case will have far-reaching impact because the construction contract at issue here is a standard form contract, substantively equivalent provisions of which are commonly employed throughout the construction industry. See PX 1, "Standard Agreement Form Between OWNER and General Contractor." This case is being closely watched by members of the construction industry because their respective interests are adversely affected by the deleterious precedent established by the court of appeals'

decision. This Court should grant review in order to make clear that general contractors, subcontractors, and material and equipment suppliers are not required to sacrifice their statutory lien rights in order to recover the compensation rightly due them for substantially performing their work under a construction contract.

The court of appeals' opinion also is extraordinary in that its holding that the general contractor forfeited the entire balance due under the contract went beyond the relief that the owner requested. According to the owner, the general contractor's failure to tender lien releases before filing suit should have resulted only in a *delay* in its obtaining payment of the contract balance, not in its outright *forfeiture* of payment:

> Once Solar clears all the liens and presents releases of the $246,627.82 in mechanic's liens, it is entitled to payment of the remaining contract price, plus retainage . . . . Thus, the failure of the condition precedent does not result in forfeiture, only a delay in payment to Solar until the liens are released.

Appellant's Motion for Rehearing, at 12. Thus, this case becomes additionally significant to the state's jurisprudence by suggesting that appellate courts can grant relief that exceeds the relief requested by the complaining party.

II. The construction contract did not require the general contractor and its subcontractors to release their liens at a time when the owner was refusing to pay any portion of the remaining balance due under the contract.

It is undisputed that the general contractor, Solar, substantially performed its work on the project. *See TA Operating*, 2005 WL 2401879, at *2 ("TA acknowledges that Solar substantially performed its work on the project . . . ."). Because it substantially performed, Solar was "permitted to sue under the contract," its "substantial performance being regarded as full performance, so far as a condition precedent to a right to recover thereunder is

concerned." *Atkinson v. Jackson Bros.*, 270 S.W. 848, 850-51 (Tex. Comm'n App.1925, holding appr'd). Solar's recoverable damages for having substantially performed were "the full contract price less the cost of remedying those defects that are remediable." *Vance v. My Apartment Steak House of San Antonio, Inc.*, 677 S.W.2d 480, 481 (Tex. 1984). Applied here, the trial court properly rendered judgment on the jury's verdict for the balance remaining on the contract price ($400,000), less the cost of remediable defects ($8,000), yielding a net judgment of $392,000. Supp CR dtd May 24, 2004; App. 1.

The legal question presented here is whether Solar was required to tender releases, not only of its own lien, but also those of its subcontractors, at a time when the owner was refusing to pay any portion of the remaining balance due under the contract. Under a proper interpretation of the parties' contract, the answer is "no."

A. Reading the contract as a whole, the"express condition precedent" was never triggered.

The correct resolution of this case turns on the application of three paragraphs of the construction contract: paragraphs 14.04 ("Substantial Completion"); 14.06 ("Final Inspection"); and 14.07 ("Final Payment"). The court of appeals focused on only one of these paragraphs—paragraph 14.07 regarding "Final Payment." *See TA Operating*, 2005 WL 2401879, at *2. By focusing on just one paragraph, the court of appeals improperly interpreted in isolation the "condition precedent" on which its decision turns. *See Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983). Viewing the "Final Payment" provision in context, a proper interpretation of the parties' contract follows.

Paragraph 14.04 of the contract governs "Substantial Completion," and provides:

> When CONTRACTOR [Solar] considers the entire Work ready for its intended use CONTRACTOR shall notify OWNER [TA] in writing that the entire Work is substantially complete (except for items specifically listed by CONTRACTOR as incomplete) and request that OWNER issue a certificate of Substantial Completion.

App. 4, ¶ 14.04. In accordance with this paragraph, by letter dated August 18, 2000, TA issued its certificate of Substantial Completion with an effective date of August 11, 2000. DX 6. Several weeks later, TA furnished Solar the "tentative list of items to be completed or corrected before final payment," as also contemplated by paragraph 14.04. *See* App. 4, ¶ 14.04. More particularly, on August 28, 2000, TA presented a "punch list" of over 300 items that it contended remained to be done before the construction could be considered finally complete. RR 3/127; PX 32. That set in motion a series of events that ultimately led to TA's unilateral termination of the contract.

Immediately upon receiving TA's 300+ item punch list, Solar's on-site project manager, Tracey Sutton, went to the property to make his own evaluation. RR 9/176. On September 1, 2000, Sutton prepared and delivered a response identifying (1) the 221 items Solar would correct, and (2) the subcontractor that would be responsible for finishing each one. PX 17. The items on TA's list that were not included on Solar's list were items that either (1) were completed by the time Solar's list was prepared, or (2) were outside the scope of the work Solar had contracted to perform. RR 9/191. On September 18, 2000, Sutton prepared an interim update delineating the status of the items. PX 18. By late September, Solar had

completed most of the items that it considered to be its responsibility, and was working on completing the rest. PX 19.

On November 13, 2000, TA wrote Solar that it was terminating the parties' agreement "for cause" pursuant to paragraph 15.02 of the contract. DX 12. In that same letter, TA claimed that it had suffered a total of $736,800.15 in damages allegedly due to purported delays and defects in construction. *Id.* By that time, only two minor items remained uncompleted: (1) a 12" x 12" area of sheetrock that needed to be sanded and painted, and (2) a ballast in a fluorescent light in a restaurant to-go area that need to be replaced. RR 3/174; 9/183.

TA terminated the contract before the Final Inspection had occurred. Final Inspection is governed by paragraph 14.06 of the agreement, which provides:

> Upon written notice from CONTRACTOR that the entire Work or an agreed upon portion thereof is complete, OWNER will promptly make a final inspection with CONTRACTOR and will notify CONTRACTOR in writing of all particulars in which this inspection reveals that the Work is incomplete or defective. CONTRACTOR shall immediately take such measures as are necessary to complete such Work or remedy such deficiencies.

App. 4, ¶ 14.06. By the time TA terminated Solar, Solar had not yet provided TA written notice that the entire work on the project was complete, as two minor items remained uncompleted. Thus, the parties had not yet made their Final Inspection at the time TA unilaterally terminated the agreement.

The sole grounds relied upon by the court of appeals for reversing the trial court's judgment was Solar's purported failure to comply with an "express condition precedent" under

the parties' agreement. *See TA Operating*, 2005 WL 2401879, at *4. That "condition precedent," however, is part of the formal Application for Final Payment, which is not submitted until *after* the Final Inspection has occurred. Only *after* the Final Inspection has occurred, and *after* the general contractor has satisfactorily completed all corrections identified during the Final Inspection, does the general contractor make its formal Application for Final Payment pursuant to paragraph 14.07[1]:

> After CONTRACTOR has satisfactorily completed all corrections identified during the final inspection . . . CONTRACTOR may make application for final payment following the procedure for progress payments.

App. 4, ¶ 14.07 A.1.

As part of its Application for Final Payment, the general contractor is required to furnish the Owner with releases or waivers of liens against the property:

> The final Application for Payment shall be accompanied (except as previously delivered) by . . . complete and legally effective releases or waivers (satisfactory to OWNER) of all Lien rights arising out of or Liens filed in connection with the Work.

App. 4, ¶ 14.07 A.2. (emphasis added). However, because TA terminated the agreement *before* the Final Inspection ever occurred and, as a result, *before* the time for Solar to make its

[1] The court of appeals' opinion states: "Solar acknowledged at least two items on the punch list had not been completed, and *submitted a final application for payment* in the amount of $472,148,77, the unpaid retainage." *TA Operating*, 2005 WL 2401879, at *1 (emphasis added). The italicized portion of this statement is incorrect. Because TA terminated the contract before the Final Inspection had even occurred, Solar never submitted "a final application for payment" within the meaning of paragraph 14.07 of the contract. In a similar vein, the court of appeals' opinion states with respect to the lien affidavit for $473,392.77 that Solar filed on October 2, 2000, that "TA understood the lien affidavit to be a request for final payment." *Id.* at *1. Any such "understanding" by TA was incorrect—the lien affidavit was simply Solar's way of protecting itself and its subcontractors in a timely manner when it became apparent that the owner was not going to pay.

formal Application for Final Payment pursuant to paragraph 14.07 ever arrived, this "condition precedent" to "final payment" was never triggered.

B. The contract does not require the general contractor to release liens when, as here, the owner unilaterally terminates the contract and refuses to make further payment.

When, unlike here, construction has progressed peaceably through the Final Inspection and "satisfactor[y] complet[ion of] all corrections identified during the final inspection" has occurred, it makes sense to require that the general contractor furnish lien releases as part of its Application for Final Payment. Indeed, if the owner is *not* fully prepared to make final payment, because the owner still deems the work not to be "acceptable," the "OWNER will return the Application for Payment [including the lien releases] to CONTRACTOR, indicating in writing the reasons for refusing to recommend final payment . . . ." App. 4, ¶ 14.07 B. Under this scheme, the general contractor and its subcontractors are called upon to release their liens *only* at the point when the owner deems "acceptable" all the corrections made following the Final Inspection, and, therefore, at a point when the owner is fully prepared to make final payment.

But what if, before the time for Final Inspection has even arrived, the owner unilaterally terminates the contract and takes the intractable position not only that much work is *not* "acceptable," but also that the general contractor is liable to the owner for hundreds of thousands of dollars in damages? In such a fractious atmosphere—with the owner making clear its refusal to pay any portion of the balance of the contract price—it makes no sense to require the unpaid general contractor to tender releases of its own lien and those of its unpaid

subcontractors prior to bringing suit for substantial performance. To the contrary, this is precisely when the mechanic's liens are needed most, particularly if there is a concern as to the solvency of the owner who is refusing to pay. Nothing in the construction contract imposes such a curious lien-release requirement on the terminated general contractor. Much less does the contract provide, or even suggest, that the general contractor forfeits all right to recovery if it fails to release all liens before bringing suit.

C. The Court should reasonably interpret the contract in a manner that preserves the mechanic's lien rights of the general contractor and its subcontractors.

This Court has held that "[t]he mechanic's and materialman's lien statutes must be liberally construed for the purpose of protecting laborers and materialmen." *First Nat. Bank in Graham v. Sledge*, 653 S.W.2d 283, 288 (Tex. 1983). The key reason behind the mechanic's lien statutes being liberally construed "is that labor and materials lose all further value to the laborer and materialman once they are furnished and put into the house or building, but they usually enhance the value of the property to the benefit of the owner and those who take under him." *Hayek v. Western Steel Co.*, 478 S.W.2d 786, 795 (Tex. 1972).

This Court can presume that the parties knew of and took into consideration the lien statutes when they made their contract. *See Coldwell Banker Whiteside Assocs. v. Ryan Equity Partners, Ltd.*, 181 S.W.3d 879, 886 (Tex.App.—Dallas 2006, no pet. h.). Thus, the protections afforded by the lien statutes should not be denied the general contractor and subcontractors under the guise of "contract interpretation." To the contrary, in case of any doubt, this Court should prefer a construction that is "rational, reasonable and probable and

will result in a contract in terms prudent men would naturally make." *National Surety Corp. v. Western Fire & Indem. Co.*, 318 F.2d 379, 386 (5th Cir.1963). Applied here, this Court should prefer a construction that preserves, to the extent possible, the lien rights conferred on the general contractor and its subcontractors by the Texas Property Code. As demonstrated above, the contract is readily susceptible of that reasonable construction.

D. This Court should avoid the forfeiture occasioned by the court of appeals' purported enforcement of an "express condition precedent," if another reasonable reading of the contract is possible.[2]

By purporting to enforce what it characterized as an "express condition precedent," the court of appeals effectively held that the general contractor here forfeited $392,000. *TA Operating*, 2005 WL 2401879, at *4. "Because of their harshness in operation, conditions are not favorites of the law." *Criswell v. European Crossroads Shopping Center, Ltd.*, 792 S.W.2d 945, 948 (Tex.1990). Accordingly, "in construing a contract, forfeiture by finding a condition precedent is to be avoided when another reasonable reading of the contract is possible." *Id.* As demonstrated above, such a reasonable reading is possible.

[2] In addition to the condition precedent never being triggered, which is briefed above, two other contract principles avoid the forfeiture effected by the court of appeals' decision: (1) the principle that when one party to a contract commits a material breach of that contract, the other party is discharged or excused from further performance, *see Mustang Pipeline Co., Inc. v. Driver Pipeline Co., Inc.*, 134 S.W.3d 195, 196 (Tex. 2004); and (2) the principle that one who prevents or makes impossible the performance of a condition precedent cannot avail himself of its nonperformance, *see II Deerfield Ltd. P'ship v. Henry Bldg., Inc.*, 41 S.W.3d 259, 265 (Tex.App.—San Antonio 2001, pet. denied). Page limitations preclude briefing in this petition these two additional contract principles.

E. The trial court's order of severance, bolstered by the Texas Property Code, protected the owner from "double liability."

The court of appeals supported its forfeiture holding by concluding that the lien-release "condition precedent" protected the owner from double liability. *See TA Operating*, 2005 WL 2401879, at *3, n.3, 4. This ignores, however, that TA was fully protected from double liability by the manner in which the trial court structured this litigation as well as by provisions of the Texas Property Code.

This is how TA articulated the "double liability" concern in its motion for rehearing of the court of appeals' initial judgment in favor of Solar: "This contract, like most construction contracts, expressly avoided the risk of the owner's having to pay the contractor for subcontractors' work and then having to pay the subs a second time in order to clear the mechanic's liens." TA's Motion for Rehearing at 3.

The trial court, however, anticipated this double-liability concern and addressed it by ordering a bifurcated trial—a point never acknowledged in the court of appeals' decision on rehearing. Before the trial of this case, the trial court issued an Order of Severance. *See* CR 106 ; App. 5. That order provided that the claims of the various subcontractors, as well as any claims by Solar or TA against the subcontractors, be severed into a separate action without prejudice to any claims or defenses, including any claims or defenses to liens filed against the property. *Id.*

Directly addressing the double-liability concern, the order required that any sums obtained by Solar in the main action (except for attorney's fees and costs) "be held in trust"

and withheld from distribution to Solar pending resolution of the claims of the various subcontractors in the severed action. *Id.* ("It is the intent of the parties, as approved by the Court, that Solar not withdraw any funds for release to itself until all claims of claimants [subcontractors] have been resolved.") The Texas Property Code lends teeth to this arrangement by making it a felony for a general contractor to misapply funds held in trust. *See* TEX. PROP. CODE § 162.032(b). Under this arrangement, the trial court ensured that TA would not have to pay "a second time" to clear the liens—the court was fully empowered to order that the various subcontractors release their liens in exchange for their receipt of their share of the funds held in trust, which would occur before Solar ever withdrew one dime of those funds for itself.

This bifurcated trial arrangement, and carefully crafted severance order, guts any notion that, to protect TA from double liability, Solar was required to effect releases of liens before even bringing suit for specific performance. If the trial court's judgment had been affirmed, the statutory lien rights of Solar and its subcontractors would have been preserved, TA would have been protected from double liability, and TA would have been entitled to have the liens cleared from its property upon final resolution of the severed claims. Instead, the court of appeals effected a forfeiture of a kind this Court has held should be avoided if possible, *see Criswell*, 792 S.W.2d at 948, and established for this and comparable future cases a lien-release requirement that unnecessarily compromises the important statutory lien rights of general contractors, subcontractors , and material and equipment suppliers, *see First Nat. Bank in Graham*, 653 S.W.2d at 288.

To be sure, the owner, TA, was entitled to a release of all liens upon final resolution of the various competing claims. The trial court was empowered to grant the owner such relief as part of its adjudication of the severed action. In no event, however, was TA entitled to the extraordinary windfall that it received by virtue of the court of appeals' judgment—TA received the benefit of a 99.8% completed building, but was relieved of the obligation of paying the general contractor, Solar, 10% of the $4 million contract price. This left Solar holding the bag—it was still contractually obligated to pay its subcontractors, but, by virtue of the court of appeals "take nothing" judgment, Solar was denied the very funds to which it was entitled to make those payments. This Court should grant review to correct the unfortunate precedent established by the court of appeals' erroneous decision.

PRAYER

Because this case presents an important question of first impression concerning the lien rights of general contractors, subcontractors, and material and equipment suppliers, this Court should grant Solar's petition for review, reverse the judgment of the court of appeals, affirm the judgment of the trial court that rendered judgment in favor of Solar, and grant Solar such other and further relief to which it is justly entitled.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served upon the following counsel of record via the method indicated below, on this the 26th day of April, 2006:

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