

Texas Construction Association

Fall 2009

REPRESENTING TEXAS SUBCONTRACTORS AND SUPPLIERS

Houston Metro Project “Parent Guarantees”

The Metropolitan Transit Authority for Harris County (METRO), began construction in mid-August, 2009, to expand its light rail transit system. METRO has entered into the \$1.46 billion dollar design-build contract with Parsons Transportation Group, Inc. an Illinois corporation. Texas law mandates that general contractors furnish payment bonds and performance bonds on public works projects. Although bonds reportedly have been secured for about \$40+ million of utility work under the contract, Houston METRO has apparently ignored the law and, according to METRO President Frank Wilson, tentatively plans to use “parent guarantees” on the remainder of the project in lieu of payment bonds and performance bonds. **This could set a very bad precedent for future Texas public projects.**

The requirements set forth in the Texas Government Code are clear and do not provide for an alternative such as “parent guarantees” on which METRO wishes to rely. Texas Government Code Chapter 2253 mandates that a governmental entity, such as METRO, require a contractor on a public work contract to post a performance bond and payment bond, each in the amount of the contract, before beginning the work. The Texas Government Code stipulates that local governmental entities must require general contractors to secure payment bonds on public projects with a value of more than \$25,000 and performance bonds for public projects over \$100,000. Payment bonds protect subcontractors and suppliers while performance bonds

protect owners. The payment bond provides the security for subcontractors and suppliers as they have no mechanic's or materialman's lien rights against the property improved on public projects. The performance bond protects the taxpayers as the ultimate owners of a public work project.

A parent guarantee of the Contractor to Metro is no protection whatsoever to subcontractors and suppliers. It is no substitute for a payment bond as dictated by state law. At best, it is a poor substitute for a performance bond. With the project security compromised, subcontractors and suppliers should fully understand their exposure. There is a provision in state law that may provide protection if subcontractors and suppliers go unpaid, but in order to make use of it, they would need to know all the requirements of bringing an action against the owner, in this case METRO.

Representatives from the surety industry and the Texas Construction Association met with METRO staff, including Frank Wilson, in July. At that meeting, METRO was advised that it was TCA's position that the bond requirement provision in Chapter 2253 is mandatory, not optional as an attorney for METRO has characterized the statute. Surety industry representatives have told TCA staff that there is sufficient bonding capacity for the project and that a bonding proposal has been presented to METRO to cover the entire project.

In mid-October, TCA President, Raymond Risk, sent a letter to Attorney General Greg Abbott supporting an open records request for financial information regarding the parent guarantees of the prime contractors involved in the \$1.46 billion METRO light rail project. The letter supported an earlier request under the Texas Public Information Act by

James D. Cupples, an attorney with the Houston law firm of Williams, Cupples and Chapman of Houston. His request asked for the financial statements submitted to METRO by the parent companies of the joint venture contractors who will construct the extension to the Houston Metro Light rail system. The request was opposed by some of the prime contractor parents. METRO did not take a position. On December 1, 2009, the Attorney General ruled that METRO must not release the confidential financial information.

TCA has received some indications that METRO is leaning toward requiring the prime contractor to furnish performance and payment bonds. As of this writing, METRO has not officially announced its final decision.

At last report, METRO still has not made a final decision that it will only require the prime contractors to provide “parent guarantees” in lieu of performance and payment bonds. METRO could still reverse its tentative decision and instead require performance and payment bonds as Texas law requires.

In a following article, Sam & Sam, Inc. has encountered payment problems on its construction jobs. Read on to find out about the company's options. ★

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The Primary Races

The current election cycle is quickly becoming one of the most interesting in recent years. Candidates have switched races, dropped out of races, and there is a new candidate for statewide office seemingly every week. The following articles will break down the candidates for the governor's race, as well as provide an overview of the possible race to succeed Kay Bailey Hutchison in the U.S. Senate, and update you on members of the Legislature who have announced that they will not run for reelection. The primary election is March 2, 2010 with the general election on November 2, 2010.

Governor's Race:

As many know, Governor Rick Perry is running for Governor for the third time. He is currently the longest serving governor in Texas' history; at the conclusion of his current term, he will have served ten years. As the sitting Lt. Governor in 2000, Perry ascended to the governorship following the election of then Governor George W. Bush to the Presidency and was first elected Governor in 2002. Prior to becoming Governor, Perry served as Lt. Governor, Agriculture Commissioner and in the Texas House. The length of Perry's tenure has allowed him to appoint every gubernatorial appointee, leading many observers to view him as one of the most powerful governors in our state's history. The main focus of Perry's time in office has been to create a business friendly environment in our state, to wit, the creation of the Emerging Technology and Texas Enterprise Funds, both of which are used to attract and retain businesses to the state. He was also instrumental in the passage of tort reform initiatives during his tenure. Perry often cites Texas' relatively strong economic performance during the national recession as evidence of the positive impact of his policies. At the same time, he has courted social conservatives with his opposition to abortion and same-sex marriage and support of prayer in school.

Throughout the race, Perry's strategy has been to maintain his social conservative base while attacking the federal government and his likely primary challenger Kay Bailey Hutchison.

Expected to oppose Perry is current United States Senator Kay Bailey Hutchison, who has served in the Senate since 1993 when she won a special election to succeed Lloyd Bentsen. Prior to her election to the Senate, Hutchison served as State Treasurer of Texas and in the Texas House. Texas political observers have anticipated this race for sometime, since Hutchison considered running against Perry in 2002 and 2006 but ultimately declined to run. Improving health care and education are two of the main issues of her campaign, and she has criticized Perry for Texas leading the nation in the percentage of individuals without health insurance. A key difference between Hutchison and Perry is Hutchison's support of the legality of abortion, although it should be emphasized that she has consistently voted to restrict abortion. Having previously stated that she would resign from the Senate sometime in October or November to concentrate on running for Governor, Hutchison recently announced that she will not resign until after the Republican primary in March, leading Perry to question her commitment to running for Governor. Hutchison cites the ongoing federal health care reform debate in explaining why she has yet to resign.

Debra Medina, former Wharton County Republican Chairwoman, is also running for the Republican nomination. She is an active supporter of current Congressman and former Presidential candidate Ron Paul. Although Paul has not officially endorsed Medina, he has solicited support for her in a letter he sent to supporters. As a political newcomer lacking Perry's and Hutchison's campaign infrastructure and fund raising capability, most observers do not think Medina has a realistic chance

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Stimulus

In February, President Barack Obama signed the American Recovery and Reinvestment Act of 2009, commonly known as the stimulus package, which injected \$787 billion into the American economy. The package provides more than \$135 billion in direct outlays for construction, the bulk of which will go towards federal, state, and local public entities for work stalled due to budget shortfalls.

Initial reports, which track the first \$16 billion in spending, show that the stimulus has allowed businesses to save or create 30,000 jobs; the construction industry accounts for a third of those jobs, in large part due to repairs on military bases. In Texas, reports show that 1,100 jobs have been created including around 780 in construction.★



Unemployment Insurance

The Texas Workforce Commission has acted to mitigate an increase in the state's unemployment insurance tax in the wake of high unemployment rates. State law requires that the "deficit assessment" automatically rise by a set amount when the balance in the unemployment trust fund falls below one percent of taxable wages. Two years ago, the Legislature gave the Commission the authority to adjust tax rates, and this is the first time the Commission has used that authority. Had the commission not voted to spread out

this assessment over the next several years, Texas employers could have paid four times as much in unemployment insurance taxes than in 2009 when Texas employers paid approximately \$1.1 billion. Although exact rates are not available and will vary among employers, unemployment insurance taxes are expected to rise to \$2.3 billion next year, \$2.68 billion in 2011, and \$2.72 billion in 2012, according to the Commission. ★



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Sam & Sam, Inc. The Texas Subcontractors

In this and subsequent issues of the Texas Construction Association Newsletter, TCA will follow the experiences of Sam & Sam, Inc., a Texas Subcontractor. The challenges they encounter, the options they weigh, and the measures they must take to be successful in the construction industry are intended to offer members practical insights and information. When we meet Samantha and Sam Samuels, who own Sam & Sam, Inc., they are an extremely busy enterprise. They have four different construction projects underway on which Sam & Sam is a subcontractor on the jobs. Although Sam & Sam's jobs are often very diversified, current good fortune has landed them contracts for projects in every category of construction: a commercial building for the bank in their hometown (Private Commercial); a new house for the bank's president (Private Residential); the new county jail (Non-Federal Public); and they are one of the subcontractors building the new federal courthouse (Federal Public). In these times, it is good to have so much work.

But recently this path of good fortune took a detour; Sam & Sam aren't getting paid on the county jail project (Non-Federal Public) and now they're about to be in a bind. The weather's been good and their crew has progressed according to schedule, but the first request for progress payment was met with no response, dead air, and now it's nearly time to submit for the second progress payment. Since they haven't been able to talk to the GC's comptroller about the subject of payment and the project manager has been vague and illusive, they can only

speculate, but they suspect that the owner is not paying the General Contractor. After a couple of other trades finished preliminary work on their phases, Sam & Sam's crew fell in line, and as usual, their work has been top notch; materials arrived timely so there were no delays, they calculated sufficient manpower, and they're confident there is no problem with product or performance. Their crew chief overheard some grumbling a couple of days ago over an alleged dispute between the GC and owner about one of the previous trades' work. Regardless the defect they're disputing, it hasn't compromised his crew's ability to work right through.

What should Sam & Sam do in order to get paid? They have paid their workers and suppliers and their company has continued to fulfill the contractual agreement. They know that suspending work is a thorny proposition, and think they may need to consult their attorney about that. They also know that certain steps must be taken, and taken in a particular time frame, in order to be entitled to protection under the payment bond claim section of the Texas Government Code. A few days ago, Sam attended a webinar on construction payment issues and he has some hand-outs that he thinks may shed some light on this predicament.

In the hand-outs they found the following information and are studying how they apply to this situation:

- **Lien Rights:** Since liens cannot be placed on public state and local public projects unless the project costs less than \$25,000 (except for municipal and DFW Airport projects where the ceiling for the project size is less than \$50,000), this option is not available to Sam & Sam, Inc. as recourse for non-payment. *For information regarding liens on "funds" of small public*



projects, see Subchapter J, Sec. 53.231, et seq., of the Texas Property Code.

- **Payment Bonds:** For the primary reason that a lien cannot be placed on public projects, state law provides that a General Contractor is obligated to provide payment bonds for all projects with a value of \$25,000 or more (\$50,000 or more when the project involves a municipality or DFW Airport). Similar to the requirements to perfect a lien, Sam & Sam must provide notice and specified information in order to perfect its claim under the payment bond. *See Chapter 2253 of the Texas Government Code.*

- **Texas Trust Fund Statute:** Under the Texas Trust Fund Act, construction payments are considered to be trust funds if the payments are made to a party for the benefit of those providing labor or materials for the improvement of real property. If Sam & Sam, Inc.'s problem involves the General Contractor or another contractor up the chain, Sam can assert the Texas Trust Fund Act to recover monies paid to that upstream contractor for the project. This statute not only provides a civil remedy but also provides for criminal penalties against a party failing to pay the construction funds it receives or diverting such funds. Sam & Sam also has protection because of legislation recently passed providing that these proceeds in the trust fund are not



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Sam & Sam the Subcontractors Continued...

subject to a bankruptcy of an upstream party. *The Texas Trust Fund Act is in Chapter 162 of the Texas Property Code*

• **Texas Prompt Payment Statute for Public Projects:** Sam & Sam may have the remedies provided by the Texas statute dealing with prompt payment involving state and local government projects. This statute and the statute dealing with private projects are similar in concept but have some differences in requirements to get interest on overdue payments. *See Chapter 2251 of the Texas Government Code.*

• **Contingent Payment Statute for Public Projects:** Sam recalls there is a contingent payment clause in their contract with the GC. Sam & Sam, Inc. may be protected by the recently enacted contingent pay statute, which requires the GC to pay in certain situations despite the inclusion of a contingent pay clause. More information about this statute can be found in *Chapter 56 of the Texas Business and Commerce Code as of September 1, 2009.*

Conclusion: What will Sam & Sam Inc. do? What would you do? As you can see, there are several statutes providing

remedies to subcontractors and suppliers. The statutes referenced above can be found on the TCA website: <http://texcon.org>, click the "Legal" link at the top of the page, and scroll down and click the "Texas Statutes" link.

Check the next TCA newsletter to find out how Sam & Sam, Inc.'s situation gets resolved. ★

The Races Cont.

to win the Republican nomination. However, if she is able to make inroads with Paul's supporters, she could be a spoiler and influence the outcome of the race.

Larry Kilgore, who advocates Texas' secession from the United States was a Republican candidate for Governor in 2006 and for 2010, but has now dropped out of the race for gubernatorial candidacy, stating however, that the will continue in the campaign for Texas secession.

Former Houston Mayor Bill White, who was prohibited by term limits from running for reelection, is now seeking the Democratic nomination in the Governor's race and has emphasized energy, education and ethics as areas of focus for his campaign. Farouk Shami, a Houston hair care executive has committed to spend \$10 million of his own money in the Democratic primary. Shami has indicated that stimulating the economy will be his top priority. Felix Alvarado, an educator and military veteran has also entered the Democratic race, places education and unemployment at the top of his concerns. Writer, entertainer, 2006 independent candidate for governor; and one-time candidate for the 2010 Democratic primary, Kinky Friedman, has dropped his bid for the Democratic nomination in favor of a run for Agricultural Commissioner. Hank Gilbert, rancher and 2006 candidate for Agriculture Commissioner has changed his original course for the Democratic nomination and will also run for Agricultural Commissioner.

Prior to announcing his interest in seeking the Democratic nomination for Governor, White was a candidate for Hutchison's Senate seat; however, shortly after her announcement that she would not resign from the Senate until after the Republican primary, White indicated that he would switch to the Governor's race. In anticipation of White's entrance into the race, former Democratic candidate Tom Schieffer dropped out of the race and threw his support to White. White will be able to use the over \$6 million he raised for

his Senate race in his campaign for Governor, and as the most politically experienced candidate, many feel he would be the favorite to win the Democratic nomination.

In the Republican primary, the race will likely come down to Perry and Hutchison. Both candidates have attacked each others' record, and most believe the campaign will become increasingly negative as the election nears. Although no hot-button issues have emerged, look for Hutchison to amplify her attacks on Perry's transportation policies and his support of the Trans-Texas Corridor, while Perry continues to point to the relative health of the Texas economy. The candidates' differing stances on abortion could also come into play. Perry is seen as the candidate favored by conservatives while Hutchison is seen as favored by moderates, leading many to feel that Hutchison's best chance at winning the Republican nomination is by attracting new voters to the Republican primary.

Looking ahead to November 2010, most observers felt, prior to White's entrance into the race, the Republican nominee would go on to win the general election. This was not an unfair assumption, since Republicans have won every statewide election since 1998. However, the prospect of a well-funded and experienced Democratic nominee in White, assuming he is the eventual Democratic nominee, facing a Republican nominee who has just emerged from a bruising primary has many Democrats confident that this could be their best chance to break the Republican stranglehold on statewide offices. Regardless, this promises to be an expensive and entertaining campaign.

Senate Race:

Kay Bailey Hutchison had previously stated that she would resign from her United States Senate seat sometime in October or November. She recently announced, however, that she would not resign until after she faces Perry in the Republican primary for Governor. In making her announcement, Senator Hutchison cited her role in the continuing health care debate and the fight over federal climate impact control legislation as reasons for delaying her resignation. If Hutchinson resigns from the Senate, Governor Perry will appoint her successor until a special election is held to fill the

remainder of her term, which runs through 2012.

As of this writing, the full affect of her decision is continuing to reverberate and has required numerous rewrites of this article. Originally, there were six candidates for her seat: Democrats Bill White, current Mayor of Houston; and John Sharp, former Comptroller; along with Republicans Florence Shapiro, current State Senator; Roger Williams, former Texas Secretary of State; Michael Williams, current Railroad Commissioner; and Elizabeth Ames Jones, also a current Railroad Commissioner and former State Representative. All of these individuals announced their intentions to run, believing Senator Hutchison would resign sometime in 2009. Shortly following Hutchison's announcement, Shapiro announced that she would run for her State Senate seat and White will run for the Democratic nomination for Governor and not run for U.S. Senate.

Since Governor Perry will appoint Hutchison's temporary successor if she resigns, whomever he appoints will have the advantages of being an incumbent, which are especially helpful for fund raising, going into the special election. Such an appointment would provide the perfect opportunity for a previously undeclared individual to enter the race, and many feel current Lt. Governor David Dewhurst will receive strong consideration for the appointment. It is a virtual certainty that Perry will not appoint a Democrat.

Of the remaining four active candidates, John Sharp has raised the most money, accumulating more than \$3.8 million; Roger Williams has raised over \$1.3 million; Michael Williams has raised just under \$500,000; and Jones has raised \$770,000.

Legislature Race:

Shifting focus to the Texas Legislature, State Senator Elliot Shapleigh (D- El Paso) has announced that he will not run for reelection. When announcing that he would not run for reelection in October, Shapleigh hinted that he would consider running for a statewide office sooner rather than later but has yet to announce any future political plans. Steve Ogden (R-Bryan), who had previously

announced that he would not run for reelection, recently announced that he will run for reelection. His change of heart came after current State Rep. Dan Gattis (R-Georgetown), one of the candidates running to succeed Ogden, expressed reservations about running. Upon Gattis' resignation from the race, Ogden reentered the contest. As of this writing, Gattis does not plan to run for reelection to the Texas House.

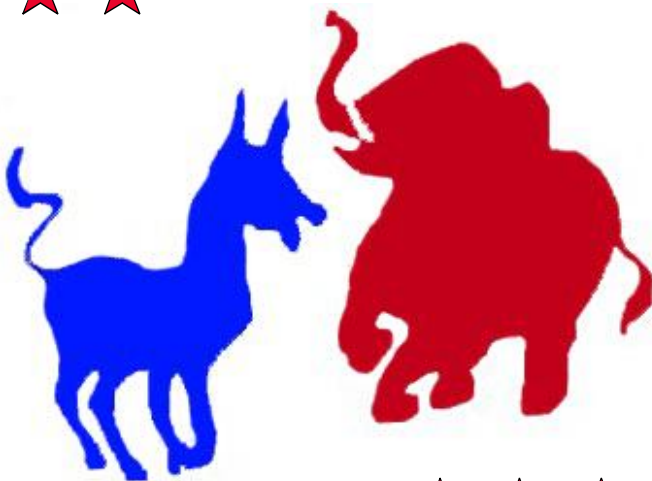
In addition to Gattis, four other members of the Texas House have announced that they will not run for reelection: David Farabee, D-Wichita Falls; Ismael "Kino" Flores, D-Palmview; Joe Crabb, R-Kingwood; and Brian McCall (R-Plano).

Republicans hold a 19-12 seat majority in the Texas Senate. However, the partisan spread is much closer in the House where Republicans enjoy a slim 76-74 margin over Democrats. Going into 2010, Democrats hope to build on these gains, while Republicans are looking to reverse a trend which has seen the Republican majority erode from 88-62 in 2003. To aid Republican efforts, Speaker of the House Joe Straus, R-San Antonio, has created a political action committee that is raising money to assist incumbent Republicans and those seeking open seats. Many observers feel that Democratic gains are the result of record turnout for the 2008 Presidential election, and that Democrats will be hard pressed to duplicate their success without Barack Obama at the top of the ticket in 2010.

The 2010 legislative elections are of heightened importance since in the 2011

Legislative session the Legislature will take up redistricting, which is the redrawing of legislative and congressional boundaries to reflect changes in population. (The Legislature is also responsible for redrawing State Board of Education boundaries and has a primary role in making changes to state judicial districts.) Redistricting is taken up in the first regular session following release of the decennial census and is often used to solidify partisan advantages.

Redistricting is an arduous process often thought of as an exercise in partisanship. In 2001 legislators were unable to come to an agreement on legislative or congressional boundaries. When this happens, the Legislative Redistricting Board, which is comprised of the Lieutenant Governor, Speaker of the House, Attorney General, Comptroller, and Land Commissioner, is responsible for redrawing legislative boundaries. In this instance, Congressional districts were redrawn, under court order, by a panel of three federal judges. As you may recall, in 2003, when Republicans had clear majorities in both chambers of the Legislature, Governor Perry called a special session to redraw congressional districts, the plan that was ultimately passed by the Legislature greatly increased the number of Republicans in Texas' congressional delegation while reducing the number of Democrats. Looking ahead to the 2011 Legislative Session, there is no doubt that redistricting will be one of the primary issues and could define the session. ★



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