# ORAL ARGUMENT – 04/23/03
# 03-0152
# INTERSTATE CONTRACTING CORP V. CITY OF DALLAS

LAWYER: This case is submitted to this court based on certified questions from the 5th circuit. The basic facts in that case involved the city contracting with ICC for the construction of levies and lakes at a sewage treatment plant. ICC in turn subcontracted with NSI. A dispute arose over who was responsible for subsurface conditions, and the additional costs that resulted from those subsurface conditions. The city took the position that the contract shifted that burden on to the contractor, and refused to pay any additional costs. It did pay the full contract price.

ICC and NSI entered into a prosecution agreement where the contractor essentially transferred the use of its name to the subcontractor. The subcontractor then prosecuted this lawsuit against the city.

ENOCH: I don't understand this pass-through issue at all. Does the contractor have a claim against the city or not?

LAWYER: As I understand it yes. It was tied to additional costs resulting to the subcontractor.

ENOCH: And so irrespective of what body is sitting over there if you win on the fact that the city does not owe the contractor any further money, the case goes away?

LAWYER: Yes.

ENOCH: If the jury concludes or the judge concludes that yes under your agreement with the contractor you owe the contractor more money, then the city loses in this case.

LAWYER: No. We have at least in the 5th circuit additional reasons why we're not responsible assuming was the claim truly brought by a contractor.

ENOCH: Well that's what I don't understand about this. Whoever that body is that's suing the city can win is if they prove the contractor has a claim against the city. That's the only way they can win. Right?

LAWYER: Correct.

ENOCH: If you establish that the contractor has no claim against the city, then the city wins in this case.

LAWYER: Correct.

ENOCH: And it doesn't really matter what body is in that chair over there. You are litigating whether or not you owe the contractor any more money. Isn't that correct?

LAWYER: That's correct.

ENOCH: Again, I don't understand the pass-through argument. If the contractor says, I'm not going to litigate whether or not I've got a claim over there, but if you want to litigate whether or not I have a claim over there, you are free to go fight this out. As far as the jury is concerned it's you against the contractor, the contractor against the city and...

LAWYER: But that's not really what happened. It turned out to be the city against the subcontractor, not the city against the contractor. We didn't enter into a contract with the subcontractor. We entered into agreement with the contractor. We didn't have the contractor present at trial.

HECHT: Are you saying that you're immuned from suit by the contractor on its own claim or not?

LAWYER: I believe that under the current law where it's involving with sovereign immunity here, there has not been a waiver of immunity from suit as to the contractor. That issue is still before the court and other matters. But the sue and be sued clauses...

ENOCH: So it would be your position that for the city to be sued on its contract you have to go to the state legislature for them to decide whether or not the city can be sued under the contract?

LAWYER: As I understand that's what this court has held is that the decision on whether or not a governmental entity can be held liable or have its immunity from suit waived depends upon the legislature. And I understand that there is a dispute about that issue. But the question as to sovereign immunity, even if your view is correct, by entering into a contract there has been a waiver that waiver should be limited in scope to a party we contracted with and not to anyone else. And that goes back to what you were talking about earlier is that we are in dispute with the subcontractor, not the contractor.

SMITH: Do we reach immunity from suit under the questions that were certified for review here?

LAWYER: No. I don't believe you need to reach those issues. Because I believe privity standing, answer those questions before you ever need to get to that issue. If you're going to approve a pass-through claim, I think you have to reach those issues.

SMITH: Why shouldn't the 5th circuit just reach those issues? They didn't ask us that third question - assuming that you reach that, please decide immunity.

LAWYER: What they did ask though is our pass-through _____ Texas law. Since this is a governmental entity involved, I don't see how you cannot reach that issue if you're going to permit a pass-through claim. Because what we're talking about is the subcontractor in effect bringing the claim against the city and we have not made a waiver either by entering into a contract with the subcontractor...

SMITH: We would be in a minority of jurisdictions if we were not to recognize a pass-through claim. So why shouldn't we join in the majority, the great trend is the other way it seems like?

LAWYER: One, as I understand there is 19 states that have talked about the issue. Three never made a decision. Three at least in part or completely have refused to recognize it. And the rest have varying degrees of it. Texas is unique in the way that it treats privity, and the way it treats standing, sovereign immunity, and most critically here is how it treats partial settlement. Because that's what in effect we're talking about here.

O'NEILL: It's my understanding that you're saying that the contractor could bring the entire analogous claim against the city.

LAWYER: If it had sustained those damages. It has not sustained those damages. Because what it is doing is, and the certified question was it's bringing this claim on behalf of the subcontractor. It's not bringing as its own damages. It's saying we're not liable on our own to a subcontractor. This pass-through component is like an agreed judgment in agreeing not to execute on that judgment.

O'NEILL: The subcontractor just has not been paid. These are overruns that are being disputed. But what if this was just the regular contract price that the owner was withholding. The contractor could bring that claim saying we're entitled to payment.

LAWYER: If the contractor had not been paid it could bring those claims because it would be a breach of its contract relating to its own damages. We're not talking about the contractor's damages. We're talking about the subcontractor's damages. And the city did not enter into the contract with the subcontractor.

HECHT: Apart from immunity if the subcontractor had sued the contractor and obtained a judgment on the theory that was asserted in this case, and the contractor had then sued the city, apart from immunity, the contractor could recover against the city on that theory?

LAWYER: Yes.

HECHT: The argument is, why make a two-step process out of it?

LAWYER: This goes back to this court's treatment of partial settlements. Is that you run

the risk of two parties agreeing who was responsible. You don't have a fair adjudication of all the facts. In our setting the subcontractor was involved in the prebid investigation. We believe that he did an inadequate job given that the contract provided that all risk of subsurface conditions were placed on them. In a true setting like what you described when you have all three parties, well the contractor naturally would have asserted the failure to do an adequate investigation as part of its defense. The contractor itself has a clause that it doesn't have to pay unless it's _____. It would have asserted that defense against the subcontractor. Instead they essentially passed the claim through and said, the contractor is wholly innocent. Well that's one of the problems, that it's an assumption by the contractor and the subcontractor as to who's responsible. And they are seeking to shift that full responsibility up to the owner.

ENOCH: But the city can raise that as a part of its defense against the subcontractor can't it?

LAWYER: Yes. But in our situation we have the contractor in name appearing and its representative was the subcontractor's president. We're not going to have a full and candid exchange of information and evidence and points of view as well as defenses when the contractor and the subcontractor are essentially merged as one.

ENOCH: Isn't your argument really that as a matter of pubic policy a contractor cannot permit its name to be used by the real party who's harmed to bring a claim under its contract against the city. Just as a matter of public policy, we're just not going to allow a contractor to give permission to the sub to go against the owner to litigate these very issues.

LAWYER: That is one of the components. And that is a real fundamental problem with allowing the use of a name to let someone else prosecute the claim that they otherwise couldn't prosecute on their own.

O'NEILL: So in this case the subcontractor would have no remedy?

LAWYER: No. He could pursue, get performance bonds, payment bonds, which may or may not be adequate, but that's a remedy that the legislature has decided.

O'NEILL: They have no remedy in court against anyone.

LAWYER: No. They could pursue the contractor.

O'NEILL: But if the theory of the case is that the owner misrepresented soil conditions, they don't have a suit against the contractor. So if the city had misrepresented something that the subcontractor relied on, under your theory they would have no judicial remedy?

LAWYER: The first problem would be that the city wouldn't be making representations to the subcontractor since it wasn't dealing with the subcontractor. It was entering into a contract

with the contractor and that's who you would be dealing with in making any kind of representations of warranties.

O'NEILL: So then the contractor could sue for misrepresentation?

LAWYER: Yes. If it had sustained the damages. The question in part is should this type of situation, a contracting situation, be treated differently than any other situation which three parties are involved? And I don't believe that they should. Because in the Mary Carter situation or State Farm v. Danby situation where you have three parties, and you have two of them that essentially allocate the responsibility and try to shift it to a third, public policy should be against allowing that because it has a tendency to distort.

O'NEILL: How do you square that with our jurisprudence that says claims are freely assignable? The contractor here could have assigned its claim to the subcontractor couldn't it?

LAWYER: Presumably it could have. Then the contractor would be still asserting the claims of the subcontractor, not its own claims. The problem is that the sub has no claims that are directly against the owner or the city, because there is a lack of privity.

ENOCH: When you're saying lack of privity, the truth is that for the subcontractor to win they can't say it's their damages. They have to say that it's damages of the contractor under their agreement with the city. If you establish that the contractor suffered no damages as a result of any conduct of the city, then the sub loses don't they. I mean the sub can't walk in and say well I suffered these damages. They have to show that you had an obligation to the contractor that you breached. It seems to me you win on your point. It has nothing to do with privity. You win on your point if in fact you have no obligation to the contractor that you've breached in this circumstance and you win.

LAWYER: Correct. That's sort of why we're here. We are talking about the subcontractor's damages that have been asserted against the city. And they have prevailed today. And we have been defending against the subcontractor's claims and not the contractor's claims.

O'NEILL: If the subcontractor had said to the contractor, and the contractor's defense was we made misrepresentations. We relied on the city's. Judgment for the contractor, the sub's out even though the city made a misrepresentation.

LAWYER: No. Because I think that the contractor in that situation can assert and will.

O'NEILL: You just posited the scenario that if the contractor _____ there, the contractor could have defended saying no misrepresentation. We didn't misrepresent the claim. We're in privity. We relied on what the city told us. We're not liable, so the subcontractor gets zeroed out against contractor. Because there's no privity they have no relief against the misrepresenter.

LAWYER: We wouldn't be misrepresenting anything to the subcontractor to begin with because we're not contracting with them.

O'NEILL: So no remedy?

LAWYER: Well there shouldn't be any costs because we're not contracting with them. We wouldn't have been making a representation on warranty of the subcontractor. It would have been to the contractor. And so if there are damages it should be the contractor's damages and not the subcontractor.

O'NEILL: You just said their whole defense is, we made misrepresentations, and they didn't.

LAWYER: I have trouble with the factual scenarios because what is the subcontractor's harm or claim or misrepresentation.

O'NEILL: If the city misrepresented some soil conditions - let's just say that there was some misrepresentation by the city. A subcontractor could never recover for that because the general is going to say, we didn't make the misrepresentation. We're not liable. The subcontractor can't sue the city. So if they have cost overruns or relied on something like that they are just out without a remedy?

LAWYER: Unless we want to overrule privity and some other standing requirements or unless the legislature provides a better remedy, yes they may be without a remedy. But I don't think that's a true scenario of what would likely happen because any other representations are going to be between the contractor and the subcontractor.

SMITH: We know that in these days when there's a construction project of this magnitude there's going to be subcontractors that are retained to do much of the work. It's conceivable that a representation from the city about soil conditions to the general contractor is going to be repeated to all the subcontractors and the contracts going to be made in reliance on that initial representation if its' a critical one. Isn't that right. We know it's going to be passed through so to speak. That representation will.

LAWYER: I guess there is the possibility that those kinds of things could get conveyed on down the line. But it still goes back to who has the city elected to contract with, and that is the contractor. We're looking to one person to be responsible to and look to be responsible to only one other person, not to the myriad of subcontractors that may or not be involved.

SMITH: So would you say that this contract between the sub and the general contractor is just void? They can't have a contract to prosecute a claim? The law just doesn't recognize that sort of contract or agreement.

LAWYER: Yes. I believe it applies in face of...

SMITH: The law just doesn't recognize it. It's a nullity.

LAWYER: It should not be recognized at least under the treatment of Mary Carter agreements and similar type of settlement agreements that represent a partial settlement as opposed to _____ encourage further litigation.

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APPELLEE

WAINWRIGHT: Mr. Miller. Looking at appellant's brief, the city's brief, on page 3 it says that the contract between ICC and the city barred ICC assignment or conveyance of any interest in the contract so that ICC was solely responsible for paying subcontractors. And it says any subcontractor has no right to create it in its favor against the city. Why doesn't that end the case? We've been talking about common law. Let's look specifically at the terms of this contract. Why don't those provisions completely answer the question?

MILLER: I am going to note at the outset that that is not a certified issue before this court. The 5th circuit has all the issues that are going to decide the merits. There are 26 of those. The sole issue before the court relate to the pass-through claim. But the answer to your question is, it is a pass-through claim. It is not an assignment. You are correct that there is an anti-assignment provision in the owner's contract.

If you look at the restatement of contracts. It says that an assignment is a complete transfer of the assignor's rights to performance by the obligor and that it's extinguished. In this case if that was true, then Interstate could not have appeared in federal court. Their name could not appear in the pleadings. They couldn't have been a party because they had completely assigned their rights to someone else.

In addition the whole notion of pass-through claims as developed in the federal system has been developed in a context where federal law - also has a very strict anti-assignment provision under federal law. Pass through claims have already been distinguished as federal law as not being assignments.

HECHT: Practically, what's the difference?

MILLER: If there was an assignment, the lawsuit would have been brought in the name of Mine Service. Mine Service would have been subject ostensibly to a counterclaim from the city. They would have been liable to the court under rule 11. They would have been the party that would have gotten judgment in their favor. They would have had the right to execute on the judgment, the right to accept money. Instead we have a situation where...

HECHT: They are the ones that are running the case. It's their witness in the chair. They are going to get the money.

MILLER: In a pass-through arrangement who finances it can be cited among the parties. Who hires the lawyer? Who hires the expert? What strategies are employed? Who sits at the counsel table? ICC could have had anyone there. They could have had his mother there, the president of the corporation. They chose to have one of the principal witnesses sit as the corporate representative. But the reality is at the end of the day the only party that will get the judgment is Interstate.

HECHT: Well if they are not going to keep the money, sure.

MILLER: The only reason they are not going to is because they have an underlying liability, the pass-through claim. They have an obligation to pay that on to Mine Services. That liability is exactly the point in the pass-through claims. That liability has never been extinguished.

HECHT: I'm just trying to understand practically what's the difference? Is there any practical difference between - I understand the legal differences, but is there any practical difference between what happens with an assigned claim and what happens with a pass-through?

MILLER: I think the practicalities are who does the money go to. And that Interstate could choose to breach the agreement, not give it to Mine Service. They do ultimately have the responsibility as a practical matter for appearing in court.

HECHT: But if everybody does what they are supposed to do there's no difference?

MILLER: The pass-through claim is designed to provide certain economies and to allow the party that suffered the damages to be able to present that easily, to have economies in the judiciary of having one lawsuit. And so yes it does look in many respects like an assignment because it has the same features, that is of economy.

WAINWRIGHT: The claims presentation and prosecution agreement, I will call the pass-through agreement, what actually did it convey from ICC to MCI?

MILLER: It conveyed an agreement that specified the methods of cooperation in the prosecution of the claim that was going to occur not through a name. It occurred through a corporate entity.

WAINWRIGHT: What were these methods that were conveyed?

MILLER: It provides who was going to control the trial strategy. Who was going to pay for that. It provided how the money would be split up. At the end it provided who would have charge of any settlement. Lots of times the subcontractor has full discretion to settle. In this

particular instance it required the consent of both ICC and the subcontractor.

WAINWRIGHT: How was the money to be split? All of it to MCI?

MILLER: No. ICC would get all of their extended performance costs, the damages that they put on, which was about $250,000 in damages we put on, plus they would get their portion of the 15% markup.

WAINWRIGHT: $1.8 million. Under your pass-through agreement how would the money be split up roughly?

MILLER: It's around $200,000 probably. It makes no difference whether the general contractor receive zero dollars. In this particular instance they will get some.

HECHT: If there weren't a pass-through the subcontractor would have to sue the contractor, and say that, which I take as true in this case, the statements made by the owner to the contractor were repeated by the contractor to the subcontractor. Those are false breach so we're suing you and the contractor is going to be inclined in that suit to say no we are not liable. And if they got tagged they would turn around and sue the owner essentially saying you owe us for what we owe him. And this just collapses that. It seems to me practically it comes down to who side is the contractor going to be on going in. Is he going to be on the other side or is he going to be on the subcontractor's side?

MILLER: Generally the contractor makes that decision based on his contract and obligations, and perceived liability. The general contractor always faces the danger that there's going to be a counterclaim filed against them. So he may not be in a position - you know if he doesn't think that there is merit to the subcontractor's claim, he's not going to enter into an agreement. He's going to say I am going to stop it here. I'm not going forward. In this instance, he evaluated it and agreed completely that it was the owner's responsibility and went forward with the action.

The only thing that was tried to this jury was the contract between the city and ICC. The jury instructions came out of that contract. The damages flowed out of that contract. There wasn't any other contract that was litigated except that one.

HECHT: And if the contractor had made independent misrepresentations to the subcontractor there is no pass-through claim on that?

MILLER: Correct. The general contractor would have liability directly to the subcontractor. And presumably the subcontractor is going to analyze that and if the real perpetrator of the wrong is the general contractor, they are not going to enter into a situation where they would go against the owner because the owner would have a defense that there was an intervening cause. It was the general contractor that caused it.

HECHT: Everybody's got a theory on why this hasn't come up before. You say it is so routine that everybody's going to say this is the law.

MILLER: I practice construction law by background. I've addressed this issue in the Missouri SC. And I would bet that if you brought members to the Texas Construction bar up here and you ask them before this question was certified are pass-through claims allowed in Texas? Everyone of them would say, yes. I use it everyday. And if you would ask them why? They would say that there's a 60 year history of jurisprudence in the federal courts that's well developed and that give all of us that practice in this area guidelines. We have a 60 year history of it providing reliable, effective, efficient and equitable resolution.

O'NEILL: It seems to me it would be more beneficial to owners in the long run because they have the contract as a buffer and it's only if the contractor is going to want to maybe agree with the owner because that's where their interest lie. There is a buffer to determine whether the subcontractor's claims is good or not. To the extent there's a tendency it's going to be maybe decide with the owner more. It does put a lot of discretion on the contractor. If they don't agree with the subcontractor's claims the subcontractor is just out?

MILLER: That's true. They have their own contract with the subcontractor. And they could resist the claim. And that does happen. But the point is that where you are in an instance where the wrong has been caused not by the general contractor, and everybody clearly agrees it's from the owner's action, and typically that's what is happening because the owner is giving directions and ordering more work, etc., but in that situation it allows the parties to efficiently litigate it. And again what's being litigated is only the city's obligation.

One of the questions that the 5th circuit asked of the city in oral argument was, tell us how has the city been prejudiced? There was no answer really given at that point and I haven't heard an answer since then. The reality is that the recovery in this case is limited by law exclusively to the terms of the city's contracts with the contractor.

HECHT: The prejudice is the same prejudice we have in all of these cases. The fellow in the middle will take sides that he wouldn't take otherwise. The contractor will take the subcontractor's side. If he were being sued himself he wouldn't take that side. He says, there were no misrepresentations. It was your fault. You should have done more testing on the soil. These are your problems. They are not my problems. They are not the city's problems. Whereas if there is a way to be in league with the other side, then your position changes. And that's what's troubling us in all these cases.

MILLER: But it still comes down to a matter of law. At the end of the day the only thing that can be recovered is what is due from the city under its contract. Let's say that the general contractor has a natural inclination to side with the subcontractor, because he says, you know this way I can avoid being sued. The reality is that the issue still has to be litigated. It still has to be a meritorious claim supported by evidence, there has to be a verdict and there's going to be a review.

So the city hasn't been prejudiced in one instance.

J. O'Neill you asked the question. What about a situation if the city had performed all of the work in this case? The city acknowledges that we wouldn't be here. It's just a matter of happenstance that this particular portion of work was given to a subcontractor. And what the city is saying is that you can't maintain this suit until you either pay all the money first to the contractor, or you go off and litigate it separately. And that is contrary to existing Texas law. We've cited to you four different cases from three different appellate divisions that all say that a general contractor does not have to first pay a subcontractor in order to recover on their behalf. And I would direct your attention to the Triton Oil case. I think it's well reasoned. And when you're looking at what constitutes pass-through _____ in Texas law, look at the Triton Oil decision, because it comes right out of Texas law and says clearly that you don't have to make payment first.

WAINWRIGHT: You indicated that there was a law that limits the city's recovery to the terms of the contract. What law is that? Is that the constitutional provision that the city argued or some other law?

MILLER: It's the law of the contract. The contract between the city and the general contractor establishes the law. And it's subject to those terms.

WAINWRIGHT: Are there cases in other jurisdictions where the courts have held or in the federal arena or other states where the courts have held that notwithstanding contract provisions that may require or may preclude any conveyance of any interest from the contractor to the subcontractor that notwithstanding any such terms that pass through agreements will be allowed?

MILLER: The important thing is the anti-assignments again is not applicable because...

WAINWRIGHT: Assume it is.

MILLER: Well it's difficult to assume that because the primary contractual relationship is defined by the subcontract. This isn't a situation where you have a third party and you're giving an assignment to them. The reason that the subcontractor ultimately gets paid under a pass through claim is because there is an underlying obligation that was established by the subcontract to begin with. The way the construction industry works unlike any other industry is that when it comes time to be paid each month, the subcontractor gives his pay request to the general contractor. And a number of them may come in. The general contractor bundles those together and gives them to the owner. The owner then passes money - this is why it's called pass-through. It means it's passing the money through. The money then goes to the general contractor who in turn distributes it to the subcontractor. Similarly if there's a change order, the subcontractor believes they are being required to do extra work, the way they do it is they pass it up the line. They send it to the general contractor, the general contractor gives it to the owner, the owner makes a reply, and the general contractor puts it back to them. The same thing with the claim's process. The claim goes to the general contractor, on to the owner and back down.

What happens in the courtroom isn't any different than what's happening throughout the contractual relationship during the administration of the contract. It just meres the contractual realities that already exist.

HECHT: In other jurisdictions suppose the owner just doesn't want that. He says, I want everybody to agree that that won't happen - the pass-through. I don't want to be subject to a pass through claim. I just want to negotiate that. I want everybody to sit down and I just want to negotiate that that won't be the case. Can that be done in jurisdictions that allow pass-through claims?

MILLER: I don't believe so because it extinguishes the general contractor's right. If you look at the Blair decision out of the US SC. It is very significant. And I would again urge you to look at that. It talks about the contractor's right to recover. In your situation the owner essentially would be asking in advance somehow for on _____ the general contractor to release or abrogate a right to recover for the value of what's been given.

HECHT: A lot of litigation about are you really on the hook, how far do you have to go before there really is some obligation to the subcontractor. And all I'm saying is can the owner agree with the general contractor ahead of time it's got to be a judgment?

MILLER: You might be able to do that. I would have to think through that. But the other reality is in the construction industry the owner has a clause in there that requires the general contractor to pay the subcontractors for the work, services, labor and equipment. Indeed it's usually an indemnification provision, and in this underlying contract they had to certify every month that they were paying those subcontractors the amount that was due them. So it would be very strange for the owner at the same time to be saying, we don't want to be responsible for paying the subcontractors.

ENOCH: You've got ICC. ICC has a contract with the city. There are people out there who think that that contract has been breached. Forget about it being a sub. ICC says I don't know whether it's been breached or not. But I will let you, Bill Smith, if you want to spend the money to litigate this deal, you can do it in my name and when we get a judgment it's going to be an ICC. And Bill says, I agree with you. I'm going to put my money in this but the only thing that's going to happen when we get the deal is either I prove that there's a breach and the damages and the money goes to your name. And you say fine. Can we craft a rule that would prohibit ICC for any claim it ever had from simply agreeing with X, Y, Z that they will be the ones that can bring a claim on their behalf? Can we say ICC you can't hire that lawyer because that lawyer really works for somebody else and not ICC? If ICC has a claim, then what interest is it of the courts to look behind ICC's claim to see why ICC's bringing the claim?

MILLER: I couldn't agree more. That's what I said, the whole question going back to Blair. What was the contractor's right to recover under the contract? That's what got litigated. What happened behind the scenes as to how that occurred, who shared in the cost, who was going

to get what, that's all a matter of contract between the general sub and the subcontractor that has nothing to do with the city. It has nothing to do with what was litigated. I couldn't agree with you more. In pass-through claims you don't get behind that.

In one of the issues you're asked to address is we're going to articulate under Texas law what is a pass-through claim, how would we do that? And I"m going to encourage you to look in particular, not only at the Blair decision but also to look at J.L. Simmons decision, 1962 out of the US Claims court. And what it focuses on is this issue of liability. But it basically says, that obviously we can say that where there's been a complete exoneration under the law, that the damage that's being complained of cannot be sought. If there's been a complete exoneration. Suppose nothing is said in the subcontract. It says in that instance there will still be an underlying liability because the basic nature of the relationship is that contractors are supposed to pay subcontractors for the work they've done. Then they talk about what's the middle ground. And the middle ground is what you see most often in the pass-through claim. And that's been fashioned now over 40 years really coming out of the J.L. Simmons case, and that is for those of us that fashion pass-through agreements, we say that the underlying liability remains that if there's a claim brought the general contractor has a continuing obligation, once they've brought that claim they have a continuing obligation to pay whatever monies are received on to the subcontractor. And J.L. Simmons provides a very good discussion of the law in that area that I would encourage Texas to adopt because it's proven the test of time.

What it says is that there is an implicit recognition of liability when parties enter into these liquidating agreements. That one of the ways that the general contractor is extinguishing its liability to the subcontractor is by going forward in this manner. And so we have a continuing liability that's there. And I think it will provide very good guidance to you. If I were to be fashioning this for the Texas SC, I would go back and I would look at Blair coming out of the US SC, and I would look at the Triton Oil decision out of the Texas CA that says, contrary to city's position you don't have to pay a subcontractor in order to bring a claim for costs or damages that they've incurred. And then I would look to the J.L. Simmons case that discusses what liability must there still be between the general contractor and the subcontractor.

HECHT: Isn't sovereign immunity implicated in a situation like this, because the subcontractor, the immunity issue might be different regards suit by the contractor than it is by the subcontractor?

MILLER: That's not the issue before the court. The answer to the question is, that the sovereign immunity is not implicated at all in this because again the claim occurs precisely within the confines of underlying contract between the city. And if the law is that there is a limited waiver of sovereign immunity that city waives its sovereign immunity when it entered into this contract with the contractor. The pass-through that's occurring all occurs within that contract. How has the city been damaged? It's liability has not been enhanced one iota. The only damages that a jury can render against it were damages under the contract, which were all foreseeable at the time by the contractor. And if you look at the Triton Oil decision it says, that in the construction industry

everyone knows, the owners know that there are going to all kinds of collateral contracts. And they even fashion it that way with subcontractors. And so there is no instance where you've got a subcontractor that's making an end-run around the general contractor that might implicate sovereign immunity

I know this is a hot issue with the court. I don't think it's implicated at all in this instance. I will also tell you that it was not preserved at the TC level and it is not an issue before the 5th circuit in this case.

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REBUTTAL

ENOCH: Suppose ICC use their own lawyers, spent their own money to prosecute the claim against the city. Could the city come in and say, well really they are doing it on behalf of a subcontractor and we're not privity to subcontractor. Could you win on that argument?

LAWYER: I believe we would if they don't have independent liability or responsibility to the subcontractor because it's not their damages.

ENOCH: You could prove it wasn't their damages because you would say this is simply a pass-through. We've paid the contractor his 15% markup and all this is is just what the subcontractor incurred in doing the job. And so we look behind what the contract is doing for them. What they are really suing for is what the subcontractor charged on this job and we have no agreement with them, so we have no liability.

LAWYER: Yes. And that's not different than what happens whenever a party is asserting damages that they themselves have not sustained. And that's what we're talking about is that we contracted with ICC. They did not sustain the damages and they never will sustain the damages. They are bringing it strictly on behalf, as the question was certified, on behalf of the subcontractor.

ENOCH: So under your agreement with the contractor - the contractor comes in and says I will build this building for you. You say yes. And the contractor says, I'll do a 15% markup on top of the actual costs. And you say that's fine. And so they come and they give you the actual cost and you say well here's your 15% markup, and now where's our completed building? And you cannot be sued for any of the actual cost of construction if it was done by a subcontractor?

LAWYER: We could be if the contractor itself is liable for those costs to the subcontractor, otherwise it is not sustaining that injury.

SMITH: That would not arise until there is a judgment against the contractor and the litigation between the sub and the general?

LAWYER: Or in the situation where they have in fact paid them.

SMITH: So once that liability is established that way there's got to be payment or judgements so that they are a judgment debtor. Only in those circumstances do you say they could then sue the city to recover?

LAWYER: Yes. And what they were talking about earlier is complaining about this payment requirement. But in the setting of equitable contribution to the extent it exist anymore, equitable subrogation, equitable indemnity payment is required until that party can pursue against the other person to bring a claim. So payment requirement is already out there. This would be an anomaly to a payment requirement.

A couple of questions were asked about the nonpayment clause. First, partial assignments at least as I understand are permissible. So whatever this use of the name is was permissible. The value of the transferring the use of the name is a right. And if it's not an assignment, I don't know what it is. Because then I think you can take any Mary Carter agreement and say, I'm not assigning my rights. I'm just going to assign the use of the name.

The one case that deals with a nonassignment clause and a pass-through was out of Rhode Island. It was Infinity Construction and they said it was prohibited by that clause. And it's the only case I know of that treats that issue.

One of the concerns was about the possibility of flows pass-throughs. It seems to me they could flow both ways. And I think some of the questions were concerned about the contractor being in a situation where it could be the highest bidder. Because the owner could make the same kind of agreement with the contractor to pursue claims in the name of the contractor against the sub. I think that just goes to show the inherent risk of allowing two parties to make some type of agreement to pursue the third.

A couple of questions regarding prejudice. And I think we were talking about misrepresentations made to the subcontractor by the contractor for the representations made to the sub. That's what we are defending. We may not have made those representations that are being asserted. And the essential problem of prejudice is, we're defending against an action and against a person we did not enter into a contract with.

HECHT: But the judgment in this case against you is on representations you made?

LAWYER: Yes. Based on the plans and specifications. And our position of course is contrary to the terms of the contract. Why hasn't this issue come up before? And I think part of that is is this court's treatment of partial settlements. It's contrary to those states that allow pass-throughs. They view partial settlements even though they guarantee additional litigation as a valid policy reason. And this state does not. And also historically this court and the CA's have always said the subcontractor looks to the contractor and the contractor looks to the _____.

SMITH: Is it true in the contract there is a provision in which you require the general

to pay the subs and to confirm that payment?

LAWYER: Yes. And in fact that would seem to support the claim that a sub could bring a claim against the contractor based on that provision. Because it should be incorporated as well.

SMITH: And then the invoices go from the subcontractor through the general and then on the subcontractor's behalf the general submits the payment invoice, accumulates them all and submits them to the owner for payment?

LAWYER: It depends on the situation. Usually there are progress payments.

SMITH: It does mirror their contention that there's a pass-through claim.

LAWYER: No. What we do is we pay essentially as it goes progress payments based on the completion of the project to date. And that's how it's framed. And the invoices are based on what the progress is.

SMITH: But the general is sort of stepping into the shoes of the subs as the facilitator for the payment for work that's done. And now they are stepping into the shoe of the sub to prosecute that same sort of claim.

LAWYER: But the difference is is that they have had the contract between the contractor and the subcontractor. That's their arrangement. That's not the city's arrangement. That's their agreement. And it shouldn't be shifted on the city because we did not enter into an agreement with any of these subcontractors.