

**RELATED
AREAS OF PRACTICE**

Education Law

SACRAMENTO

400 Capitol Mall, 27th Floor
Sacramento, CA 95814
Tel: 916.321.4500

BAKERSFIELD

5080 California Ave., Suite 250
Bakersfield, CA 93309
Tel: 661.864.3800

SAN LUIS OBISPO

1432 Higuera Street
San Luis Obispo, CA 93401
Tel: 805.786.4302

WALNUT CREEK

1350 Treat Boulevard, Suite 105
Walnut Creek, CA 94597
Tel: 925.395.2380

WWW.KMTG.COM

Legal Alerts are published by Kronick Moskowitz Tiedemann & Girard as a timely reporting service to alert clients and other friends of recent changes in case law, opinions or codes. This alert does not represent the legal opinion of the firm or any member of the firm on the issues described, and the information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorney with whom you normally consult.

California Supreme Court Holds that Contractor May be Entitled to Relief for Public Entity's Nondisclosure of Information that Materially Affected Contractor's Performance of Construction Contract

In *Los Angeles Unified School District v. Great American Insurance Company*, (--- Cal.Rptr.3d ----, Cal., July 12, 2010), the California Supreme Court considered whether a contractor could recover additional compensation from a school district because the contractor was required to perform work that the school district had failed to disclose in the construction contract or "pre-punch lists." The Supreme Court held the school district may be held liable if the totality of the circumstances show that the school district knew or had reason to know that "a responsible contractor acting diligently would be unlikely to discover the condition that materially increased the cost of performance."

Facts

The Los Angeles Unified School District ("District") hired a construction company to build an elementary school. However, the District terminated the contract because the contractor breached the contract and defaulted. The District sought proposals from other contractors to complete construction and correct the defects left by the first contractor. The District provided prospective bidders with copies of the original plans and specifications and with "pre-punch lists" that cataloged the "work by the previous contractor that the District's inspectors and subinspectors found to be defective, incomplete or missing." The pre-punch lists only referred to defects visible by a simple inspection but included language that "the District also intended to make the contractor awarded the job responsible for unlisted defects in existing work."

The District accepted the proposal from Hayward Construction Company ("Hayward") that contained a "guaranteed maximum price" of \$4.5 million. Hayward agreed in writing "to correct deficiencies in the work performed by the former contractor, without limitation, as noted" on the pre-punch lists. After work began, Hayward notified the District that it had

Note:

This Legal Alert updates our previous Legal Alert on this case entitled, "Court Must Consider Extrinsic Evidence In Dispute Over Interpretation Of The Terms Of A Contract," July 9, 2008.

underestimated the cost to fix the previous contractor's work because there were "nonconformities and deficiencies that had not been noted on the pre-punch lists and could not have been detected by simple observation." The pre-punch lists stated some of the plaster surfacing needed to be repaired and cleaned. However, Hayward had to remove and replace the entire exterior surface and a portion of the underlying material. Hayward discovered the entire installation of tile was unacceptable but the pre-punch lists only called for fixing tiles at a few locations.

Hayward sought from the District \$2,847,592 for the work that had to be performed because of latent defects. Although the District disputed that Hayward was entitled to any extra compensation, it paid Hayward \$1 million. The District expressly reserved the right to take action to recover the \$1 million. The District filed a lawsuit against Hayward and Great American Insurance Company, who had issued a performance bond guaranteeing Hayward's performance of the contract. Hayward filed a cross complaint against the District alleging it was entitled to additional compensation because it was required to perform work that had not been specified in the pre-punch lists or the contract.

The trial court granted judgment in favor of the District. The court of appeal reversed the judgment in favor of the District and found Hayward could maintain a cross action against the District if it could show that "the District knew material facts concerning the project that

**RELATED
AREAS OF PRACTICE**

Education Law

SACRAMENTO

400 Capitol Mall, 27th Floor
Sacramento, CA 95814
Tel: 916.321.4500

BAKERSFIELD

5080 California Ave., Suite 250
Bakersfield, CA 93309
Tel: 661.864.3800

SAN LUIS OBISPO

1432 Higuera Street
San Luis Obispo, CA 93401
Tel: 805.786.4302

WALNUT CREEK

1350 Treat Boulevard, Suite 105
Walnut Creek, CA 94597
Tel: 925.395.2380

WWW.KMTG.COM

Legal Alerts are published by Kronick Moskowitz Tiedemann & Girard as a timely reporting service to alert clients and other friends of recent changes in case law, opinions or codes. This alert does not represent the legal opinion of the firm or any member of the firm on the issues described, and the information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorney with whom you normally consult.

would affect Hayward's bid or performance and failed to disclose those facts to Hayward."

Decision

The Court recognized that a contractor who has agreed to perform a contract "at a specified price may not avoid its contractual obligations or seek additional compensation for performing them because unanticipated difficulties are encountered." However, a contractor undertaking a public works contract who, although "acting reasonably, is misled by incorrect plans and specifications issued by the public authorities as the basis for bids and who, as a result, submits a bid which is lower than he would have otherwise made may recover in a contract action for extra work or expenses necessitated by the conditions being other than represented."

The Court held that a contractor such as Hayward does not need to show that a public entity had a "fraudulent intent to conceal." The public entity must "have been aware it possessed material information unknown to the contractor" but it is not required that the public entity had "an affirmative intent to deceive." However, the public entity does not have an "obligation to investigate the costs of performance independent from the obligation to provide prospective bidders with correct plans and specifications." Also, a public entity is not responsible for a contractor's erroneous assumptions when the public entity provides the correct information.

The Court found that "a public entity may be required to provide extra compensation if it knew, but failed to disclose, material facts that would affect the contractor's bid or performance." A public entity, however, does not insure a contractor against the contractor's own negligence. A public entity may only be held liable for nondisclosure if the following conditions are met: "(1) the contractor submitted its bid or undertook to perform without material information that affected performance costs; (2) the public entity was in possession of the information and was aware the contractor had no knowledge of, nor any reason to obtain, such information; (3) any contract specifications or other information

furnished by the public entity to the contractor misled the contractor or did not put it on notice to inquire; and (4) the public entity failed to provide the relevant information."

The circumstances that may affect recovery by a contractor include (1) "positive warranties or disclaimers made by either party," (2) "the information provided by the plans and specifications and related documents," (3) "the difficulty of detecting the condition in question," (4) "any time constraints the public entity imposed on proposed bidders," and (5) "any unwarranted assumptions made by the contractor." A "public entity may not be held liable for failing to disclose information a reasonable contractor in like circumstances would or should have discovered on its own." Instead, the public entity "may be found liable when the totality of the circumstances is such that the public entity knows, or has reason to know, a responsible contractor acting diligently would be unlikely to discover the condition that materially increased the cost of performance."

What This Means To You

In competitive bid projects, be sure to disclose all material information in the District's possession that could affect the cost of the work. This not only will prevent extra costs in the middle of construction projections, it can avoid delays and ensure that the most qualified bidders are selected for the work.

Questions

If you have any questions concerning the content of this Legal Alert, please contact the following from our office, or the attorney with whom you normally consult.

Diana D. Halpenny | 916.321.4500