SHEPPARD MULLIN
SHEPPARD MULLIN RICHTER & HAMPTON LLP
ATTORNEYS AT LAW

Construction & Infrastructure Law BLOG
New Legal Developments in the Construction & Infrastructure Industry

Construction & Infrastructure Law Blog

April 7, 2011 by Sheppard Mullin

The Year 2010 In Review: Public Works Projects

This article is the fifth in a series summarizing construction law developments for 2010.

By Candace Matson, Harold Hamersmith & Helen Lauderdale

A. Bidding

1. Great West Contractors Inc. v. Irvine School District, 187 Cal. App. 4th 1425 (4th Dist. Aug. 2010)

In Great West Contractors, the Fourth District held that a public agency's rejection of a bid for a public works project on the basis that a corporate bidder did not list its officers' licenses is a question of bidder responsibility, not bid responsiveness, and therefore a due process hearing was required. The Court of Appeal said that the case is important for two reasons. First, it presents a challenging problem in public contracting law: how to distinguish a "non-responsive" bid from a *de facto* determination that the bidder is not a "responsible" bidder. Second, the case presents what the court called "an object lesson in how evidence that, at least on its face, tends to show favoritism – indeed, on this record, favoritism most foul – never got squarely presented to, or considered by, the trial court." The Court invited readers of the opinion to judge for themselves whether "stonewalling" might not be a better word than "delay" for describing the public agency's actions.

The School District sought bids for the renovation of two elementary schools. All bidders were pre-qualified. Plaintiff, Great West Contractors, submitted the lowest bid on each project. Nonetheless, its bid was rejected as non-responsive. In response to the question in the bid package, "Have you ever been licensed under a different name or license number?" Great West responded "No." The School District subsequently determined that Great West had in fact operated under different license numbers and its president was listed as an RME under a different license number, and on that basis the School District determined that Great West's bid was non-responsive and it was therefore rejected in its entirety. The way by which this came about is what provoked the court's "favoritism most foul" comment. The Court related that a competing bidder, for a reason never adequately explained by the public agency, had access to Great West's bid information within 24 hours of the opening of all bids. Thus, the competitor was able to present a bid challenge almost immediately to the School District based on the allegation that Great West had omitted to disclose some licenses with which it or its principals had been associated. And that competing bidder went on to be awarded one of the contracts. But when Great West tried to get a copy of that very same competitor's bid, the School District did

not turn over that information until several weeks later – indeed, the information was deliberately not made available until after the critical first court hearing in the case. And then, when Great West finally did get the information on its competitors' bids, it discovered that its successful competitors had been guilty of the very same omission with regard to the disclosure of all associated licenses that was the ostensible reason that Great West's bid was summarily rejected in the first place.

Great West filed a petition for writ of mandate generally arguing that it should have received the contract award. After two hearings, the trial court held that Great West's bid was non-responsive, and even if Great West had a due process right to a hearing due to its non-responsiveness, any relief would be moot inasmuch as the work had already begun and Great West could no longer be awarded the contracts at issue. Additionally, the trial court entered judgment against Great West.

The Court of Appeal ruled first that, although the projects were already completed, the question presented on appeal – whether plaintiff's failure to list its officers' licenses constituted an issue of bid responsiveness or bidder responsibility – was not moot. The work was already complete, and the School District argued that therefore a court should not decide the propriety of its rejection of Great West's low bid. The Court of Appeal reasoned, however, that the non-responsive vs. non-responsible issue presented is "a classic example of an issue capable of repetition yet likely to evade review. Consider: in public contracts of a short lead-time nature, like the one here, an initial determination by the public agency that the lowest bid is 'non-responsive' allows for a summary rejection of that bid that may readily preclude effective judicial redress."

The Court of Appeal added that the issue is of great public concern. A school district is legally required to award contracts to the lowest responsible bidder. This statutory mandate may be bald-facedly circumvented if the school district need simply declare the bid non-responsive, then award the contract to the next (and perhaps favored) bidder.

The court then went on to address the merits of the case, discussing the difference between non-responsibility and non-responsiveness. The Court cited, *inter alia*, the Taylor Bus Service case which stated that responsibility is a "complex matter dependent, often, on information received outside the bidding process and requiring, in many cases, an application of settled judgment, whereas responsiveness is "less complex" and "can be determined from the face of the bid." The Court ultimately held that the allegation of falsity with respect to Great West's response to the bid question made it clear that the School District's rejection of its bid was an issue of non-responsibility, not non-responsiveness. The Court of Appeal reversed the judgment below, finding that the School District had erred in rejecting Great West's bid without allowing it a hearing on the issue of responsibility, and further finding that the trial court had incorrectly denied Great West the opportunity to amend its claim to seek damages (bid preparation costs) consistent with Kajima/Ray Wilson v. Los Angeles County Metropolitan Transportation Authority, 23 Cal. 4th 305 (2000).

2. Schram Construction Inc. v. Regents of University of California, 187 Cal. App. 4th 1040 (1st Dist. Sept. 2010)

The Regents of the University of California awarded a general contract to DPR Construction for the design and construction of a medical center. On the University's behalf, DPR solicited bids for the mechanical, plumbing and electrical work on the project. Subcontractors were invited to bid on six individual packages and three alternative combination packages. After learning which subcontractors had bid on each package, DPR and the University decided to award a contract on a certain combination package instead of two individual packages. Southland Industries was determined to be the lowest responsible bidder on the combination package. Plaintiff, Schram Construction, which had submitted bids on the two individual packages but not on the combination package, filed a petition for writ of mandate challenging the award of the contract to Southland. The trial court denied Schram's petition.

The Court of Appeal reversed, concluding that the University's bid package selection procedure violated Public Contract Code Section 10506.4(c) – which requires it to "adopt and publish procedures and required criteria that ensure that all selections are conducted in a fair and impartial manner" and to disclose to prospective bidders how the best value bid will be selected, including the bid selection procedure and the determinative factors in that decision -- where it selected the bid packages based on undisclosed criteria and in a manner that allowed it to predetermine the outcome of the bid selection. The Court held that section 10506.4 required publication of the bid package selection criteria and that publication was necessary to a fair and impartial bid selection. The Court was particularly concerned that the bid selection had turned on a criterion that had not even been disclosed to the bidders. In concluding that the contract with Southland must be set aside, the Court stated that the University's violations of the competitive bidding statutes were not merely "technical or non-substantive," and that they compromised the integrity of the selection process by failing to ensure procedural and substantive fairness.

3. Graffiti Protective Coatings, Inc., et al. v. City of Pico Rivera, 181 Cal.App. 4th 1207 (2d Dist. Feb. 2010)

Through competitive bidding, plaintiff had been awarded a public works contract to maintain a city's bus stops. Four years later, the City terminated the contract as allowed by its terms. Without inviting competitive bids in accordance with Public Contract Code sections 20161 - 20162, the City entered into a new contract with one of plaintiff's competitors. Plaintiff filed suit for a writ of mandate and declaratory relief to invalidate the new contract and to compel the City to award the contract through competitive bidding.

In response, the City filed a special motion to strike, contending that the action was a "strategic lawsuit against public participation" (SLAPP) (Code Civ. Proc., § 425.16(b)(1)). The trial court granted the motion, reasoning that the maintenance of the City's bus stops was an issue of public interest and plaintiff was not likely to prevail on the merits of its claims. Under the anti-SLAPP statute, the City was entitled to an award of attorneys' fees, which the trial court fixed at over $24,000.

In reversing the trial court's decision, the Court of Appeal held that, even if plaintiff's claims involve a public issue, they are not based on any statement, writing, or conduct by the City in

furtherance of its right of free speech or its right to petition the government for the redress of grievances. Rather, plaintiff's claims are based on state and municipal laws requiring the City to award certain contracts through competitive bidding. Thus, the claims are not subject to the anti-SLAPP statute. It follows that plaintiff does not have to demonstrate a probability of success on the merits at the pleading stage, risking the dismissal of its claims and the payment of the City's attorneys' fees. If the court were to conclude otherwise, the anti-SLAPP statute would discourage attempts to compel public entities to comply with the law.

B. Methods of Proving Damages – Total Cost and Modified Total Cost Theories

1. Dillingham-Ray Wilson v. City of Los Angeles, 182 Cal. App. 4th 1396 (2d Dist. Mar. 2010)

In this case, the Court of Appeal reversed a decision of the trial court, which had precluded the contractor from proving damages by the method it proposed and had ruled that neither a total cost theory nor a modified total cost theory was permissible. The first sentence of the Court of Appeal's opinion stated: "The City of Los Angeles obtained millions of dollars worth of construction work that it does not want to pay for." It only went further downhill for the City after that.

Dillingham-Ray Wilson (DRW) had been awarded a contract by the City to expand the digester capacity at the Hyperion Wastewater Treatment Plant. During the course of construction, the City issued over 300 change orders which contained more than 1,000 changes to the plans and specifications. On rare occasions, the City directed DRW to perform changes on a time and materials basis. But in most instances, the City requested an estimate of the cost of the work, told DRW to start the work, and agreed the parties would negotiate a lump-sum payment at a later date. The parties agreed on the compensation payable for some of the time and materials change orders and lump-sum change orders, but not all of the change orders were ultimately agreed. When DRW completed the job, it requested an equitable adjustment to compensate it for the work performed without a price, and for expenses and losses allegedly resulting from the City's interference and delays. The City refused, and it assessed liquidated damages against DRW for delays and did not release the retention funds from escrow.

DRW sued the City for breach of contract, and the City cross-complained against the DRW on various theories including under the False Claims Act. Based on Amelco Electric v. City of Thousand Oaks, 27 Cal. 4th 228 (2002) and Public Contract Code Section 7105(d)(2), the City filed motions in limine to preclude DRW from presenting a total cost claim and from proving its damages with engineering estimates rather than actual costs. It also barred DRW from proving its damages on a modified total cost theory.

The case proceeded to trial on DRW's claims for delay damages, wrongfully withheld retention and prompt pay penalties, and on the City's cross-complaint. After post-trial motions, judgment was entered in favor of DRW in a net amount exceeding $30 million. Both parties appealed.

The Court of Appeal reversed the rulings which had limited DRW's damages proof, finding that the contract was ambiguous regarding restrictions on the proof and measure of damages. It remanded the case for a further trial on the interpretation of the contract. The Court also held that

PCC Section 7105 and applicable case law restrict only the measure of damages and not the method of proving damages. It ruled that if, following remand, the trial court or jury interprets the contract and concludes that it does not require DRW to document actual costs on the change orders, and if engineering estimates are the best evidence of damages available, then DRW can offer those estimates to prove its claims. The Court also found that there is no legal prohibition on using a modified total cost theory (total cost of performance, less the contract amount, less any unreasonable cost) to prove damages on a public works contract. Therefore, DRW would be allowed to use this method to prove its damages on remand if the contract does not require it to document its actual costs.

C. Change Orders

1. P & D Consultants, Inc. v. City of Carlsbad, 190 Cal. App. 4th 1332 (4th Dist. Dec. 2010)

The Fourth District Court of Appeal held that a contract with a public agency cannot be modified orally or through conduct of the parties when the contract provides that no amendments, modification, or waivers of contract terms were allowed without a written agreement signed by both parties.

This breach of contract action arose from a written agreement between P & D Consultants and the City of Carlsbad for services pertaining to a redesign of the City's municipal golf course. The contract provided that no amendments, modification, or waivers of contract terms were allowed without a written agreement signed by both parties. The parties executed several written amendments, which increased the contract price for extra work. Because the City typically took several weeks to execute each amendment, the City's project manager often authorized P & D to begin work prior to receiving the signed amendment. The parties disagreed on the scope of work and price for Amendment No. 5, but ultimately executed it for slightly less than half the value P & D believed it was due. P & D later sought more money from the City, apparently for work P & D thought should have been included in Amendment No. 5. The City refused to pay and P & D sued. The City cross-complained for deficient and incomplete work. The jury found the City liable for breach of contract and awarded P & D the full damages it requested, $109,093.81.

The City appealed, contending that as a matter of law, the jury's award for extra work could not stand because there was no written change order. The Court of Appeal held that the judgment for P & D must be reversed "because as a matter of law, it cannot recover for extra work without a written change order, as the parties' contract requires." The Court held that the trial court erred in finding that the contract could be modified orally or through conduct, and that it should not have allowed the case to go to the jury on the modification theory. The Court cited to Katsura v. City of San Buenaventura, (2007) 155 Cal. App. 4th 104, which held that contracts with public entities cannot be modified orally and that people dealing with public agencies are "presumed to know the law with respect to any agency's authority to contract." The Court stated that any oral authorization by the City's project manager was insufficient to bind the City, and that the plain language of the contract limited the City's power to contract to that set forth in the contract.

D. Public Agency's Failure to Disclose

1. Los Angeles Unified School District v. Great American Insurance Co., 49 Cal. 4th 739 (July 2010)

The Supreme Court held in this case that a contractor need not prove an affirmative fraudulent intent to conceal as part of a cause of action for non-disclosure of material facts or breach of the warranty of correctness of the plans. The Court framed the issue as "whether a contractor may also recover when the plans and specifications are correct, but the public authority failed to disclose information in its possession that materially affected the cost of performance." The Court expressly disapproved of the language used in the 1979 decision in Jasper Construction, Inv. v. Foothill Junior College District, 91 Cal. App. 3d 1, which had held that to recover for non-disclosure the contractor must show the public entity affirmatively misrepresented or intentionally concealed material facts that rendered the furnished information misleading.

The School District had ejected a contractor from a school construction project claiming material breach of contract. The School District solicited proposals from other contractors to correct defects and complete the project. Bidders were provided with copies of the original plans and also with a 118-page list of work that the District's representatives found to be defective or incomplete. The list contained language that was intended to hold the contractor responsible for all listed defects. Hayward Construction submitted a bid to perform the work on a time and materials basis with a guaranteed maximum price of $4.5 million. Shortly after starting work, Hayward notified the District that many defects had not been included on the correction list and could not have been discovered by simple observation, and that it therefore had significantly under-estimated the cost of the remedial work. Hayward alleged that the District had failed to disclose the full nature and extent of the defects in the existing construction, and had failed to disclose information that would have put Hayward on notice that some of its assumptions about the scope of the work required were faulty. For example, Hayward asserted that the District had failed to disclose a consultant's report that would have alerted Hayward to the defects in the stucco work and further asserted that the District was aware Hayward's intended method for curing stucco discoloration would not be effective. The trial court granted the School District judgment on the pleadings, rejecting Hayward's claims of breach of contract and breach of warranty, reasoning that under Jasper, Hayward could not recover because it had not alleged facts that would allow a conclusion that the District either actively concealed or intentionally omitted material information. The court entered judgment in favor of the School District in an amount exceeding $1.1 million.

The Court of Appeal reversed, holding that Hayward may maintain an action for breach of contract based on non-disclosure of material information if it could establish that the District knew material facts concerning the project that would affect Hayward's bid and failed to disclose those facts. The Supreme Court affirmed the decision of the Court of Appeal, though it concluded that the Court of Appeal's ruling was overbroad in suggesting that recovery may be had for any failure to disclose material information . The Supreme Court held that the contractor on a public works contract may be entitled to relief for a public entity's non-disclosure in the following limited circumstances: (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 Court elaborated that the circumstances affecting recovery may include, but are not limited to, positive warranties or disclaimers made by either party, the information provided by the plans and specifications and related documents, the difficulty of detecting the condition in question, any time constraints the public entity imposed on proposed bidders, and any unwarranted assumptions made by the contractor. The 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, but 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.

E. MBE, WBE, and DVBE Preferences

1. Coral Construction, Inc. v. City and County of San Francisco, 50 Cal. 4th 315 (Aug. 2010)

In the latest decision arising out of the City and County of San Francisco's series of ordinances granting preferences in the award of public contracts, the California Supreme Court upheld the constitutionality of Article I, Section 31 of the California Constitution, which forbids a city awarding public contracts to discriminate or grant preferential treatment based on race or gender. The City, whose public contracting laws expressly violate Section 31, challenged its validity under the so-called political structure doctrine, a judicial interpretation of the federal equal protection clause. The Court concluded that Section 31 does not violate the political structure doctrine.

For the last 26 years, the City has preferentially awarded public contracts to minority-owned business enterprises (MBE's) and women-owned business enterprises (WBE's). The City's Board of Supervisors has mandated these preferences in a series of ordinances adopted over time, justifying each with legislative findings purporting to show continuing discrimination by the City against MBE's and WBE's. The details of the program have evolved, partly in response to changes in the law governing the validity of such preferences. The plaintiffs in this case, Coral Construction Inc. and Schram Construction Inc., challenged the 2003 version of the ordinance as unconstitutional under Section 31.

Section 31, which the voters approved as Proposition 209 in the November 1996 General Election, declared that the State, including its political subdivisions, "shall not discriminate against, or grant preferential treatment to, any individual or group on the basis of race, sex, color, ethnicity, or national origin in the operation of public employment, public education, or public contracting."

In rejecting the City's argument that Section 31 violates the political structure doctrine – an aspect of federal equal protection articulated in Washington v. Seattle School District No. 1, 458 U.S. 457 (1982), the Court emphasized that Section 31 prohibits race- and gender-conscious programs which the federal equal protection clause *permits* but does not *require*. The Court also rejected the City's contention that the ordinance was unaffected by Section 31 because it falls within an exception which applies in instances where action must be taken to establish or maintain eligibility for federal funding. The City, which receives federal funds for a variety of

projects, argued that it was compelled to enforce its ordinance by specific federal regulations imposing affirmative action obligations on cities that receive funds. The Supreme Court held, as the Court of Appeal had held, that the City's argument lacks merit.

Finally, the City contended that the federal equal protection clause requires its ordinance as a remedy for the City's own discrimination. The Court of Appeal had reversed the Superior Court's decision relating to this argument and remanded the case for the limited purpose of adjudicating that issue. The Supreme Court held that the Court of Appeal ruled correctly in remanding the federal compulsion argument for further proceedings. The Court did offer guidance to the Superior Court in resolving the federal compulsion issue on demand. The Court said that to defeat plaintiff's motion for summary judgment, the City must show that triable issues of fact exist on each of the factual predicates for its federal compulsion claim, namely (1) that the City has purposefully or intentionally discriminated against MBE's and WBE's; (2) that the purpose of the City's 2003 ordinance is to provide a remedy for such discrimination; (3) that the ordinance is narrowly tailored to achieve that purpose; and that a race- and gender-conscious remedy is necessary as the only, or at least the most likely means of rectifying the resulting injury.

Authored By:

Candace L. Matson is a partner in Sheppard Mullin's Los Angeles office where she specializes in construction law. Harold E. Hamersmith is a partner in the firm's Los Angeles office specializing in design and construction contracts, claims, and defects litigation, and public contract law. Helen J. Lauderdale is a special counsel specializing in construction litigation in Sheppard Mullin's Los Angeles office.