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Blissful California Dreamin' Interrupted, Less Likely After Opinski and Other Recent Extra Work Cases

Construction Practices Newsletter

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Contractors looking for gold in California will have to mine harder these days to find it in public works construction contracts after *Greg Opinski, P&D Consultants*, and other recent decisions. Thus, California contractor clients are asking their lawyers:

> "What if the board of the public entity refuses to approve a change order on extra work we already performed because the owner's field representative promised to get it approved?"
>
> "In light of recent court decisions holding 'no board approval, no payment,' does a contractor have to honor the owner's direction to perform disputed extra work?"
>
> "Can a contractor sue for 'equitable adjustment' under California law?"

California lawyers are debating and wondering as well...

> "Are the doctrines of waiver, estoppel, prevention or forfeiture essentially invalid for public contracts?"
>
> "Can public contracts have an 'oral modification,' or are there other ways to avoid owner dictated short notice or high standard of proof provisions?"

These questions and similar ones relating to "extra work" on California public works projects have been the subject of high-stakes litigation between the construction bar and public entity lawyers in recent years, with California appellate courts and the California Supreme Court

providing several controversial opinions on the issues. To the extent possible, the purpose of this article is to attempt to reconcile the key decisions, and identify the remaining "gray" areas in the law.

The Dilemma

Construction is a dynamic process. Most public contracts in California anticipate changes and disputes over extra work. In fact, like elsewhere, a standard clause in California public contracts gives the owner a right to direct the contractor to proceed with any disputed extra work and the contractor must comply, reserving resolution for later. However, some of these same contracts also prohibit the contractor from performing "extra work" without obtaining the public entity governing board's approval in the form of a signed and authorized change order. One problem is that many governing boards meet infrequently and require weeks of lead time to place items on their agendas.

Further, many public boards are politically motivated, and board members often criticize consultants managing their projects if there are extras, disputes, claims, or delays, without regard to the real causes of these events. Also, for both owners and contractors, those in the field involved in managing construction projects are typically business people – not politicians – and they are properly motivated by what is best for the project, often informally agreeing to just get the work done with promises to negotiate pricing for extra work later. Finally, as though anticipating an ignorant owner that is not actively managing the job, most public contracts also require stringent notice and proof requirements for a contractor to obtain payment for a change order, even if the public entity initiates the change request.

The combination of these factors often lead to a "Morton's Fork" (a choice between two undesirable paths; see, www.wikipedia.org/wiki/Mortons_fork) for contractors, where they must decide whether to proceed at their own risk with extra work (often with the assurance of

eventual payment and later board approval from the owner's representative), or else halt construction and await board approval knowing that halting work generates owner-dreaded claims. Sometimes the stakes are raised because the owner's representative has directed the contractor to proceed and threatened to default the contractor if it stops working. With such circumstances, here are the major cases to keep in mind.

Protecting the Public Coffers?: Cases for Public Entities

A number of cases have directly or indirectly decided the issue of extra work on the rationale of protecting the public coffers, and preserving the competitive bid statutes.

> ***Zottman v. City & County of San Francisco*** [20 Cal. 96 (1862)]

In 1862, the California Supreme Court decided that poor Henry Zottman could not recover for owner directed extra work. Zottman was constructing improvements to Portsmouth Square in San Francisco. Part of the work involved constructing an iron fence around the square. There was no question that the original contract was legally awarded. After examining the plans and specifications, the special commission authorized to manage the job for the city determined that a "stone base" should be used instead of wood to make it more durable, and that the fence needed to be painted to keep it from immediately rusting and deteriorating.

> The superintendent and special committee ... in presence of the city attorney, the president of the board of aldermen, and of different members of the board, ordered the contractors to perform the extra work mentioned [...] and assured them that the city would pay them therefor. In conformity with this order the extra work was performed ... And the testimony in the case shows that during its progress all the members of the common council must have been aware of the order to the contractors, as the work was in full view from the windows of the council chambers, and was the subject of general

> conversation and approval by the members at their various sessions and elsewhere, and no opposition to it was ever expressed by any member. [*Id.*, at 99]
> Zottman presented a bill to the city, which never approved it. He sued, and then appealed to the California Supreme Court after the city obtained a non-suit.

The Supreme Court examined the city's charter provisions, determined that the exclusive manner for authorizing work for public improvements was through the common council and via a specific mode of procedure based on public bids, which was not done for this extra work. Perhaps significantly, the court noted there was no authority for the superintendent or special committee to direct the contractor to perform extra work or for the council to ratify payment for extra work. On these findings, the California Supreme Court ruled that Zottman could not recover, reasoning it was as much Zottman's obligation to comply with the city's charter as it was the obligation of the City Council.

El Camino Community College Dist. v. Sup. Ct. [173 Cal.App.3d 606 (1985)]

El Camino involved a dispute between a supplier and college district. The agreement contained an arbitration clause and two vice presidents of the college district had signed it together with the supplier. However, the college district's board had not approved or ratified the agreement. At the trial court, the supplier was able to compel arbitration. However, the Court of Appeals issued a writ of mandate directing the trial court to vacate its order compelling arbitration since the college district could not be bound to an agreement that its board did not approve. Additionally, the appellate court found that the college district could not be estopped from challenging the legality of the agreement for "strong public policy" reasons. It further commented, arguably in dicta, that the doctrine of estoppel was not applicable to a municipal agency that has not complied with a statute limiting its power to act.

Amelco Electric v. City of Thousand Oaks [27 Cal.4th 228 (2002)]

One-hundred and forty years after *Zottman*, in *Amelco*, the California Supreme Court ruled that the "abandonment" theory is not available on public contracts. As the court explained:

> Under the abandonment doctrine, once the parties cease to follow the contract's change order process, and the final project has become materially different from the project contracted for, the entire contract – including its notice, documentation, changes, and cost provisions – is deemed inapplicable or abandoned, and the [contractor] may recover the reasonable value for all its work. [*Id*., at 239]

Citing public policy, *Zottman*, and Public Contract Code section 7105 (which restricts public contract amendments, modifications and terminations to instances where the public contract allows them and limits them to the manner provided for in the public contract), the court found the "abandonment" theory for recovery was invalid and inconsistent with laws applicable to public contracts. The court did recognize, however, arguably without reconciling the issue, that a public entity is liable for a breach of its public contract in the same manner as a private party. [*Id*., at 242] It also then went on to rule that Amelco failed to meet the test to allow the trial court to instruct the jury on the total cost method of calculating damages for breach, arguably implicitly recognizing that had Amelco met the test, the instruction would have been proper, even though the city argued that claims could only be submitted at the times and in the manner provided in the contract, which apparently required a discreet damage claim for each change.

P&D Consultants v. City of Carlsbad [190 Cal.App.4th 1332 (2010)]

P&D involved an engineering consultant's contract with the city. The contract stated that "no amendments, modifications, or waivers of contract terms will be allowed absent a written agreement signed by both parties." [*Id*., at 1336.] There were four change orders issued in signed writings. In connection with each, the "customary" approach was for the city's representative to get verbal city approval, authorize the extra work in writing, have P&D perform the extra work, and then later the City Council would formally approve it and execute a change order. This was done because the "[c]ity typically took several weeks to execute an amendment." On the fifth change for extra work, the parties utilized this same process, but P&D and the city could not agree on the amount up front so the city only authorized time and materials work up to a maximum of $99,810. P&D contended it was required to do more than this amount and sued for the difference. The court held neither the owner's oral authorization nor the parties' conduct was sufficient to support a claim since a fully executed change order was required in its terms. The court rejected P&D's equitable estoppel, waiver and ratification arguments because they were raised for the first time on appeal.

Greg Opinski Construction, Inc. v. City of Oakdale [199 Cal.App.4th 1107 (2011)]

In October 2011, the Fifth Appellate District of the California Court of Appeal issued an opinion that arguably turned the tide considerably in the public owner's favor. The court held a 38-year-old decision that stated an owner may not assess liquidated damages against a contractor for delays that are actually the owner's fault, regardless of whether or not the contractor ever submitted a timely and proper time extension is not the law in California. In determining that legal precedent to be invalid, the court held that where a contract contains specific notice requirements for obtaining an extension of time and a contractor fails to comply with them, it is barred from later contesting its liability for project delays.

In *Opinski*, a city entered into a contract with a general contractor for the construction of a building project. The contract provided for completion of the project within 300 days and provided for liquidated damages of $250 for each day of delay. The project was completed seven months late. The general contractor brought suit against the city for the unpaid balance of the contract and for $24,436 in proposed change orders the city had refused to approve. The city filed a cross-complaint against the contractor seeking $54,000 in liquidated damages for not completing the project on time. The contract provided that the contract price and time for performance could only be changed through a written change order. The contract further provided that the contract time could only be extended if the contractor made a claim pursuant to the terms of the contract. The contractor never made a claim for an extension of time. Nevertheless, relying on the *Peter Kiewit* decision (see discussion below), the contractor argued that liquidated damages could not be awarded for any portion of the delay that the city caused, even if the contractor failed to comply with the contract's provisions for obtaining an extension.

In ruling against the contractor, the court distinguished *Peter Kiewit*, pointing out that the Legislature amended California Civil Code section 1511 two years after the *Peter Kiewit* opinion was issued, and as a result effectively superseded *Peter Kiewit* with the change in the statute. According to the *Opinski* court, under the amended and current version of section 1511, parties to a construction contract may agree that a contractor "intending to avoid the effect of its failure to perform by asserting that [the owner's acts] caused the failure must give written notice of this intention within a reasonable time." In short, the *Opinski* decision continues a court trend of insisting on stricter adherence to contractual change provisions, even if it means the contractor may be stripped of otherwise valid claims or the owner is factually responsible for the claim. It remains to be seen whether the case will be appealed to the California Supreme Court, or what the true impact will be.

Seemingly at Odds?: The Contractor Cases

Peter Kiewit Sons' Co. v. Pasadena City Junior College Dist. [59 Cal.2d 241 (1963)]

As discussed above, the viability of the *Peter Kiewit* holding is now doubtful. The *Peter Kiewit* case involved a contractor's failure to comply with public contract terms on claims for final payment and a dispute over delay damages against a college district. The project was subject to a liquidated damages clause in the contract and the contractor completed the job late. The contract also provided that the contractor had to submit a request for a time extension in writing to the architect to be granted a time extension. At trial, the evidence showed project delays were excusable to the contractor (i.e., beyond its fault or control), but that the contractor failed to request extensions in writing for these delays. On such facts, the trial court denied the college district's right to withhold money for liquidated damages and the Court of Appeals agreed. Rejecting the college district's arguments that the contractor had to comply with the contract to receive an extension of time and be excused from liquidated damages, the California Supreme Court recognized the application of Civil Code section 1511, which invalidates any clause in a contract that charges one contracting party with delay when the other party caused the delay in full or part, even where the contract stipulates expressly to the contrary. Accordingly, the California Supreme Court affirmed the award for the contractor based on a finding of excusable delays.

Los Angeles Unified School Dist. v. Great American [49 Cal.4th 739 (2010)]

The case involved a contract to correct construction defects in a partially constructed school and complete the school construction. Bidders were given the plans and specifications for constructing the new school and "punch lists" for correcting items of the partial construction already performed by a terminated contractor. After Hayward Construction began work under its fixed price contract, it informed the district that it had significantly underestimated the cost

of the remedial work, which had deficiencies that had not been noted on the punch lists or the plans and specifications. Hayward sought additional compensation for these defects. The California Supreme Court overruled prior case law and held that a contractor does not have to show fraud or an affirmative intent to conceal in order to prevail on a claim of nondisclosure against the public agency. The Supreme Court established the following four-part test for a non-disclosure claim: (1) the contractor submitted its bid or began performing the work without material information, (2) the information was in the public entity's possession and the public entity knew or had reason to know a reasonable contractor would be unlikely to discover it on its own, (3) the contract specifications or other information furnished by the public entity misled the contractor or did not put it on notice to inquire, and (4) the public entity failed to disclose the relevant information to the contractor.

Dillingham-Ray Wilson v. City of Los Angeles [182 Cal.App.4th 1396 (2010)]

Dillingham-Ray Wilson (DRW) sued the City of Los Angeles in connection with unresolved change orders, interference and delays. During the project, DRW submitted more than 300 change orders. Some were approved on a time and materials basis. Some were conceded as a change, the city then directing DRW to perform the work with the issue of the amount of change order to be resolved later. At the end of the job, when the city and DRW could not agree on the amount of compensation due, DRW sued for "equitable adjustment" in addition to delays and interference. To support its claims, DRW intended to submit engineer's estimates of its costs for the unpaid extra work. The contract had numerous clauses addressing extra work, including one clause that indicated disputed extra work would be paid based on "actual cost" records. The contract was silent as to what precise records were sufficient to show actual costs, or how the contractor was to maintain those records. At trial, the city successfully moved in limine to exclude the contractor's evidence of damages on several of the change orders, pursuant to the contract and Public Contract Code 7105, which states:

> [Competitively bid public contracts] may be terminated, amended, or modified only ... if so provided in the contract or [] authorized under provision of law other than this subdivision. The compensation payable, if any, for amendments and modifications shall be determined as provided in the contract. ...

The city argued that the contract restricted DRW's ability to present evidence at trial. DRW argued that the contractual requirements were impossible to comply with under the circumstances.

The Court of Appeal disagreed with the trial court and reversed the prior rulings. The court found that the contract was ambiguous as to the restrictions on the proof and measure of damages. It also found that section 7105 only restricted the measure of damages, not the method of proving those damages. Accordingly, if engineer's estimates provided the best evidence of damages available to DRW, then it could offer those estimates as proof of its damages. Finally, the court found that the modified total cost method of proving damages is permissible in California.

Conclusion

Over the past 20 to 30 years, the tides have been turning in California. While the courts have not effectively addressed all the Civil Code sections that might affect public contracts (such as Civil Code 3275 reflecting a distaste for forfeitures), nor effectively reconciled the notion that public entities that contract do so as any other person does, the body of case law that was once favorable – or at least neutral – to public contractors in California eroding like the beachside cliffs in Malibu. And the roadmap that contractors and their lawyers use to maneuver through the public contract minefield is changing. As the current trend in the cases indicates, courts are more inclined to strictly enforce the agreement between the parties and courts are more willing than they have been in the past to restrict and limit a contractor's right

to recover against a public entity, regardless of the real fault. This is problematic because, oftentimes, strict compliance with the notice, claims and change order provisions of these contracts is quite difficult, inconsistent with the owner's interests of efficiency and cost savings, and contrary to the parties' practical approach of working out problems while the project is ongoing. Additionally, over time when competition in the market evens again, contractors are also likely to add a hefty premium in pricing for the heightened contractual risks in California public jobs.

What both owners and contractors can take away from these cases is that diligence and attention to all contract provisions is essential, and a strong knowledge of public law and its limitations is more important than ever. Contractors should avoid "understandings" in the field that conflict with contract terms. For owners, if anticipating a fair number of changes due to the nature of the project, consider giving contractual authority for changes not to exceed certain dollar limits – if legally possible – to a field representative in order to avoid delays while change orders await governing body approvals.

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