

Construction Practices

NEWSLETTER

[Highlighting notable court decisions and trends]

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California Supreme Court: Breach Claims Against Public Entities Subject to Statutory Claim Requirements

In *City of Stockton et al. v. Superior Court of Sacramento County (Civic Partners Stockton LLC)*, the California Supreme Court not surprisingly confirmed that a plaintiff filing suit alleging breach of contract against a public entity must comply with the Government Code claim requirements and timely present a claim to the public entity before filing suit. Several appellate decisions held this very same thing (see e.g., *Canova v. Trustees of Imperial Irr. Dist. Employee Pension Plan*, 150 Cal.App.4th 1487, 1493-1494 (2007); *Baines Pickwick Ltd. v. City of Los Angeles*, 72 Cal.App.4th 298, 303-304 (1999)). There were, however, a few appellate courts that held that the Government Code claim requirements only applied to tort-based claims (see e.g., *Harris v. State Personnel Board*, 170 Cal.App.3d 639, 643 (1985) disapproved on other grounds in *Coleman v. Dept. of Personnel Administration*, 52 Cal.3d 1102, 1123, fn. 8 (1977); and *Gonzales v. State of California*, 68 Cal.App.3d 621, 627 (1977)). The court's decision ended any split on the issue.

In *City of Stockton*, a redeveloper, Civic Partners Stockton LLC, sued the City of Stockton and the Redevelopment Agency of the City of Stockton, for, among other things, breach of contract related to Civic Partners' redevelopment of a hotel and the new construction of a building. After two challenges to Civic Partners' complaints, Civil Partners filed its Second Amended Complaint. The City and the Agency raised Civic Partners' failure to comply with the Government Code claim requirements. The trial court rejected the challenge to Civic Partners' Second Amended Complaint, holding that the Government Code claims statutes "did

not affect contractual liability." The City and the Agency petitioned the appellate court for a writ of mandate and the court of appeal agreed with the City and the Agency and held that the Government Code required Civic Partners to submit a claim before filing suit.

Civic Partners petitioned the California Supreme Court for review.

The California Supreme Court undertook a detailed statutory analysis, reviewed the legislative history behind the pertinent Government Code statutes and looked at existing case law on the issue. The Court also evaluated the purpose behind the statutory scheme (i.e., to prevent surprise to public entities and provide public entities sufficient information and time to adequately investigate and evaluate claims before litigation ensues). Based thereon, it confirmed that contract claims "fall within the meaning of the requirement that all claims for money or damages be presented" to public entities before litigation. The Court rejected Civic Partners' argument that Government Code section 814 did not require the filing of the claim before filing suit because it provides, in relevant part, "Nothing in this part affects liability based on contract or the right to obtain relief other than money or damages against a public entity or public entity." The Court held that section 814 only pertains to immunity issues relative to liability and has no effect on the claims requirements. The Court clarified that the previous reference to the "Tort Claims Act" is outdated and decreed that, because of the broad scope of the claim requirements, Government Code sections 810 et seq. will now be referred to as the "Government Claims Act."

Again, this result was not unexpected. However, this ruling is significant because now contractors in direct privity

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with a public agency know for a legal certainty that they must comply with the Government Claims Act requirements before filing suit unless otherwise provided by statute. Thus, practitioners and their clients should know that there are two limitations periods applicable to contractors – the time limitations within which to bring claims under the Government Claims Act (or other applicable statute), and the applicable legal statute of limitations within which to file suit.

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Contract Termination: Proactive Measures to Protect Your Company in Later Litigation

An owner's or contractor's well-reasoned decision to terminate a contract often does not seem like such a good idea when, in the middle of ensuing litigation, it becomes apparent that there are substantial shortcomings related to project documentation or testimony provided from within your own "camp." While such realities are typi-

cally not fatal to a party's litigation position, they can have a substantial impact on elements of damages claims and can damage a party's credibility in the eyes of the judge and jury.

The checklist in this article is an inventory of "best business practices" to consider in the course of terminating a contract that, if followed, will reduce instances of litigation headaches and surprises.

Record Keeping – Just because you have record-keeping policies in place does not mean they are being followed. Tightening them up should eliminate having to reconstruct parts of the job file months – or years later during litigation – and will reduce instances of missing or misfiled documents.

- Get all filing up to date and, once it is done, have the employee responsible for administrative oversight on the project confirm the files are in good order.
- Make sure comprehensive field and meeting notes are being kept and that problems are recorded in substantial detail.
- Promptly resolve outstanding proposed change orders (PCOs) and requests for information (RFIs), as well as any other "loose ends" that may later be blamed for work or payment delays or build problems.

Project Relations – Even if you are in the right in terminating the contract, the other side will try to make you look bad at trial by using specific incidents of seemingly questionable conduct at the job site against you.

- Avoid doing anything that could be construed as impeding work at the project.
- Advise your employees to mind their manners on the job site and to refrain from making unprofessional comments to the other side.

Preparing for Termination – It is imperative that you follow all termination procedures in the contract to the letter and that you are current on the law that will be applied in litigation.

- Review the entire contract to pinpoint all conditions potentially relevant to the termination process and take note of all contract provisions that may come into play in your favor or against you in litigation. This exercise serves three purposes: (1) you will be fresh on the contract's termination procedures, which reduces the possibility of any being overlooked in the run-up to termination; (2) it ensures that you will remember to address all relevant issues in termination correspondence; and (3) it will help in posturing that correspondence to mesh with your position in later litigation.
- Consult with counsel regarding the current state of the law on termination and familiarize yourself with court decisions that have similar fact patterns as your situation or interpret identical or similar language as in the to-be-terminated contract. A termination consistent with the state of the law should be of benefit in litigation; the opposite is true as well.

Communication Policies – "Everything you say can and will be used against you in a court of law." Be very careful of what you say and write.

- Designate one person to serve as the contact point for all further communications with the other side. This will eliminate the possibility of the other side complaining they were being told different things by different people. This employee will likely be your "star" non-expert witness at trial and, as such, make sure to choose a person who is well spoken, smart and can be trusted to exhibit discretion when dealing with the other side.
- Remind all employees that they should consider everything they put in print as being subject to production in a lawsuit. Tell them that they absolutely must refrain from making any derogatory or otherwise less-than-neutral comments about the other side in e-mails, memos, correspondence, notes, etc. that could be used to besmirch your reputation at trial.
- The same goes with spoken words. Assume everyone you speak with about the project could be called to

testify in deposition and at trial.

- Preserve all documents, including all emails.

Preservation of Project Knowledge

– Do not wait until you are in litigation to pull together documentation and preserve recollections of important issues.

- Work with your lawyer to develop a plan to "capture" your employees' knowledge of important project issues and to create a historic record of the conflicts leading to termination, and compile documents on operative issues in potential litigation. (It is important that this is conducted under the instruction of counsel and that any writings or recordings generated in the process are directed to counsel in order to preserve attorney-client and work product doctrine privileges.)
- Employee interviews.
- Chronology of events.
- "Hot docs" (important documents on operative issues).

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Under California Statute, Only 'Awarding Authority' Has Power To Award Penalties

In *Thompson Pacific Construction, Inc. v. City of Sunnyvale* (2007) 155 Cal. App.4th 525, the California Court of Appeal held that trial courts are without jurisdiction to impose penalties for violations of the Subletting and Subcontracting Fair Practices Act (Public Contract Code Section 4100 et seq.), and that only the public entity that awarded the contract (the "awarding authority") has such power.

The purpose of the act is to give public entities some control over who works on their projects and to prevent "bid shopping" by prime contractors and "bid peddling" by subcontractors after a contract is awarded. Generally stated, the act requires that prime contractors on public works projects list in their bids the names of their subcontractors and the portions of

work to be performed by each. Then, when a prime contractor is awarded the contract, it is “locked in” to its listed subcontractors and must use them on the project except in nine statutorily defined circumstances and with the awarding authority’s consent.

For a violation of the act, the awarding authority may assess a penalty of up to 10 percent of the amount of the subcontract at issue. If the violator is the prime contractor, the awarding authority may instead choose to cancel the contract.

Thompson Pacific involved the construction of a senior center for the City of Sunnyvale. The contract required that the general contractor (Thompson) achieve substantial completion by a specified date. Thompson failed to complete the project on time, and the city (the “awarding authority”) complained that certain work was deficient. Thompson sued for withheld retention payments and the city countersued. Among the city’s counterclaims was an allegation that Thompson violated the act by improperly substituting subcontractors that were not listed in its bid documents. At trial, the jury rejected Thompson’s claims and awarded the city \$91,000 in penalties for Thompson’s violations of the act.

Thompson appealed, arguing that the trial court was without jurisdiction to impose penalties under the act because the act expressly provides that the “awarding authority” has discretion to impose penalties. Thompson argued that the court had not merely acted “in excess of its jurisdiction,” in which case the jurisdictional defect could be deemed to have been waived and the losing party estopped from challenging the award. Instead, Thompson contended that there was a fundamental lack of jurisdiction, meaning “an entire absence of power to hear or determine the case.” On appeal, the court agreed with Thompson and reversed the penalty award. It noted that the act plainly gives the awarding authority discretion to impose penalties, and that unlike other statutory schemes such

as the California False Claims Act, nothing in the act allows the awarding authority to pursue a civil action for monetary penalties. It also noted that, while courts have many inherent powers they may exercise to accomplish complete justice between parties, they have no power to award civil monetary penalties in the absence of explicit statutory authorization. As a consequence, the trial court had no power to impose penalties under the act. Further, because the jurisdictional defect was “fundamental,” the court held that Thompson was free to challenge the court’s ruling and was not estopped to contest the award: “A judgment rendered in the absence of fundamental jurisdiction is simply a nullity.”

The city argued that it was entitled to pursue a civil action for penalties under the act because it did not learn about all of Thompson’s violations until discovery had commenced after the lawsuit was filed. The court rejected this argument, finding that the city could have assessed penalties against Thompson notwithstanding the pending lawsuit. The court noted, “[t]he city’s argument seems to suggest that it was precluded from exercising its own discretion to impose penalties [under the act] by the time litigation had commenced.”

The upshot of the *Thompson Pacific* decision is that the act is fundamentally an administrative tool for which the awarding authority, not the court, holds the power. The awarding authority has the power to impose statutory sanctions for violations of the act, and the awarding authority must take charge and use this power instead of looking to the court for relief. Similarly, a general contractor or subcontractor must petition the awarding authority for relief under the act and not sit back only to seek relief through litigation later. Power under the act is reserved to the awarding authority; the court’s role is merely to determine whether the awarding authority’s exercise of its power was within its discretion.

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Killer Bond Forms and Contract Provisions—A Series

This is the fifth in the ongoing series setting forth examples of new bond and contract provisions and providing commentary as to their meaning and impact.

Penal Sum Increases with Change Orders up to X%

The Penal Sum of this Bond shall automatically increase as the Contract Amount increases; provided, however, the initial Penal Sum shall not increase more than ___% absent written consent from the Surety. Surety’s refusal to consent to such an increase in the Penal Sum shall not be a breach of this Bond.

Provisions by which the penal sum of the bond increases with change orders are becoming increasingly more common. Traditionally, bonding companies charge premium for change orders but do not have their bond penalties, the bond amount, increase correspondingly. Bonding companies do so because the performance bond covers the change order work, i.e., guarantees its completion. And, the contract price increases with each change order such that there is money available to complete the change order work. Thus, bonding companies argue there is no reason to increase the penal sum; it merely sets the bonding company’s limit of liability on its bond.

For there to be a situation where the obligee needed the penal sum to increase with change orders, the cost of completing the work would necessarily need to exceed both the remaining contract balance and the entirety of the original penal sum pegged at the original contract price in order for the surety’s liability to cap. In practice, there are relatively few instances where the penal sum comes into play.

As a compromise, it appears that the bonding industry has been able to convince obligees (owners and general contractors) that insist upon having

the penal sum increase with change orders to limit the percentage increase without bonding company consent. The above provision is a sample of that. The last sentence of the clause is quite essential. Otherwise, the percentage limit would be meaningless. If the bonding company refused to have its penal sum increased beyond the percentage limit and, because of that, the obligee declared the bond principal in default for failing to have the required bond, the bonding company would be facing a demand for performance. Between facing a default and having the contractor continue performance, the bonding company would be forced to consent, allowing the obligee to increase the penal sum at will.

Scope of Bonding Company's Liability

In no event, however, shall Surety be required to pay more than a sum equal to [1] the original contract price as amended from time to time together with [2] any additional sums accruing as the result of amendments to the original contract prior to default and [3] sums necessary to remedy any damage or depreciation suffered by the project, with the exception that in addition hereto, Surety shall be required to pay [4] all costs and attorney's fees the Oblige incurred in enforcing the Bond.

By using the words "in no event, however, shall Surety be required," this provision is worded in a way to make it appear as if there is some limitation as to the bonding company's liability on the bond. However, the four categories of damages for which the bonding is liable essentially encompasses the entirety of what a bonding company could be liable for under a performance bond and more, including change orders, costs to correct defective construction or depreciation, and attorney's fees and costs. It essentially increases the penal sum of the bond not just for change orders but for remedial work, depreciation and attorney's fees.

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Construction Practices Group

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