ISSUE TO BE BRIEFED

The issue to be decided is whether a contractor bringing a claim against a public agency based on the theory of breach of implied warranty of the completeness and accuracy of the plans and specifications ("Breach of Implied Warranty") must prove intentional concealment of material facts.

The answer is no. A contractor bringing a claim against a public agency based on the theory of breach of implied warranty must not be required to prove intentional concealment of material facts because to do so will not only fly in the face of the Legislature's general intent behind the enactment of (and subsequent proposed amendment to) California Public Contract Code § 1104, but will cause inherent unfairness in the construction industry as a whole.

INTRODUCTION

Amicus Curiae, includes the American Subcontractors Association a national non-profit corporation supported by the membership dues paid by its approximately 5,000 member businesses operating as construction subcontractors and suppliers throughout the country. ASA has more than 400 subcontractor firms located in California with American Subcontractors Association of California (ASAC) having five chapters in the state. Additionally, a number of other construction trade associations as outlined in the *Amicus Curiae* application support this effort since the opinion of the trial court, if allowed to stand, will have significant adverse consequences for subcontractors who do business in California and on the California public at large.

ASA supports defendant-appellant Hayward Construction Company, Inc. (“Hayward" or "Completion Contractor”) in plaintiff-respondent Los Angeles Unified School District’s (“LAUSD” or “Owner”) appeal of the ruling by The Court of Appeal, Second Appellate District, Division Two (“Court of Appeal”). The ruling by the Court of Appeal reversed a decision made by the Los Angeles County Superior Court (“trial court”) which precluded Hayward from maintaining a cause of action for Breach of Implied Warranty absent an allegation of facts that LAUSD intentionally concealed material information with respect to the plans and specifications for the completion of the construction of the project more commonly known as the Queen Anne Place Elementary School (“Project”).

The Court of Appeal subsequently reversed the order of the trial court that prevented Hayward from maintaining its breach of contract claim against LAUSD based on misrepresentation or nondisclosure of material facts. In this regard, the Court of Appeal noted that "[t]here is a conflict of authority as to whether a contractor must prove intentional concealment by the public agency in order to recover on a claim for nondisclosure of material facts." (*Los Angeles Unified School Dist. v. Great American Ins. Co.* (2008) 163 Cal.App.4th 944.)

Several appellate districts in California have held that such a showing is necessary, in part to avoid burdening public agencies with liability where the contractor underbid work due to lack of diligence. In contrast, the Third District Court of Appeals has rejected any requirement of affirmative misrepresentation or active concealment. The Third District properly reasoned – and the Second Appellate District in this matter agreed – that a public owner has a legal duty to

disclose information if doing so would have "eliminated or materially qualified the misleading effect of the misrepresentation." (*Welch v. State of California* (1983) 139 Cal.App.3d 546.) In other words: non-disclosure of a material fact "is itself an affirmative act sufficient to constitute active misrepresentation." (*Ibid*.)

As such, the Court of Appeal here reversed, finding that the Completion Contractor:

> "may maintain a cross-action for breach of contract based on nondisclosure of material information if it can establish that the [Owner] knew material facts concerning the project that would affect [the contractor's] bid or performance and failed to disclose those facts."

The Court of Appeal's reversal of the trial court's ruling here is proper and must be allowed to stand as such a ruling is in line with the longstanding principles set forth in *United States v. Spearin* (1918) 248 U.S. 132 and its progeny as well as with the legislative intent behind the enactment of California Public Contract Code § 1104. This Court's decision will have a direct and profound impact on the fiscal atmosphere in California's public works industry and on the ability of subcontractors, including ASA and ASAC's members, to conduct their subcontracting businesses.

ASA and ASAC's position, as argued in this brief, is that public policy will best be served by an affirmation of the Court of Appeal's ruling. If the lower court ruling is permitted to stand, ASA and ASAC are concerned that such a holding will essentially give public agencies the green light to 'unintentionally' or negligently issue inaccurate plans and specifications for public construction projects since any subsequent suit for Breach of Implied Warranty will require a

contractor to bear the high burden of showing that the public agency actually intended to conceal material facts in the construction plans and specifications.

The public agency is and will always be in the best position to work with the design agency in drafting the plans and specifications and thus, to then relay the accuracy of such information to the contractor. If the Court of Appeal's ruling is reversed and contractors on public construction contracts are required to prove that a public agency intentionally concealed material facts in a Breach of Implied Warranty cause of action, such a showing of intent will essentially take away the existing responsibility on the public agency to warrant against the accuracy of plans and specifications.

Not only will this unreasonably place the brunt of any accountability for the correctness of plans and specifications directly onto the contractor, but will undermine existing California law as codified in the California Public Contract Code ("Pub. Contract Code"). Specifically, there is an existing duty under Section 1104 of the Pub. Contract Code that requires public agencies to warrant the accuracy and correctness of plans and specifications. LAUSD's claimed concern that failing to require contractors to prove a public agency intentionally concealed material facts in a Breach of Implied Warranty cause of action will cause public agencies to act as insurers for contractors is wholly misplaced.

Any requirement of a showing of intent will not broaden a public agency's existing responsibilities, but rather, will merely cause the public agency to engage in acts that it is already required to do under existing law – that is, to work with the design agencies to draft

accurate plans and specifications and ensure that if contractors build according to such plans and specifications, the resulting work will be correct.

Additionally, the effect of mandating contractors to prove intentional concealment of material facts in a Breach of Implied Warranty claim will be detrimental to the taxpaying public at large. If the ruling of the Court of Appeal is reversed, contractors bidding for upcoming public works projects will surely increase their bid amounts as well as place contingencies in their contracts, thereby resulting in an overall increase in the total cost of constructing public works projects. Such costs will surely be shifted onto the shoulders of the already over-burdened taxpaying public. Thus, principles of public policy and inherent fairness call for this Court to affirm the decision of the Court of Appeal in allowing a contractor to maintain a cause of action for Breach of Implied Warranty without being required to prove that a public agency intentionally concealed material facts.

STATEMENT OF THE CASE

In March 1996, following competitive bids required by law, the Owner of the Project entered into a $10.1 Million dollar contract with Lewis Jorge Construction Management, Inc. (Lewis Jorge), to build a new elementary school. In February 1999, the Owner had become dissatisfied with Lewis Jorge and terminated it for default. The Owner's governing board adopted a declaration of emergency under the California Public Contract Code to allow the Owner to enter into a completion contract without competitive bidding. The Owner nevertheless sought proposals from other general contractors for the completion and correction costs.

To this end, it created a "pre-punch list" for the potential general contractors to identify: (1) the remaining work and (2) the work to be corrected. The "correction lists" consisted of a 22-page pre-punch list prepared by the Architect, and an 86-page pre-punch list prepared by the Owner's inspectors. The pre-punch lists contained numerous disclaimers, including one by the Owner's inspectors that the list was "a courtesy … list and should not be taken as a final inspection punch list." Three general contractors, including Hayward Construction Company, Inc. ("Hayward" or "Completion Contractor") submitted proposals. Hayward was awarded the contract.

In June 1999, the Completion Contractor and Owner entered into a cost-plus with a guaranteed maximum price ("GMP") completion contract for the Project (the "Completion Contract"). The not-to-exceed price of the Completion Contract was $4.5 Million Dollars ($ 4,500,000.00).

The Completion Contract stated that the scope of the Completion Contractor's work included "without limitation" the items listed on the pre-punch lists as deficiencies in Lewis Jorge's work. During the deposition of the Completion Contractor, there was testimony from Hayward that during initial contract negotiations with the Owner, Hayward was assured that the scope of their obligation to correct defective work was "limited to items on the pre-punch list." After Hayward and the Owner executed the Completion Contract, defendant-appellant Great American Insurance Company (the "Surety") issued a performance bond for $ 4.5 million to guarantee the Completion Contractor's performance.

Not long after the Completion Contractor began work, a dispute arose about responsibility for correcting work that was not listed in either of the pre-punch lists. In December 1999, the Completion Contractor advised the Owner that it needed to increase the GMP beyond $ 4.5 million to account for these 'unforeseen' conditions. The Owner eventually issued a purchase order for $2 million to complete the project under an express reservation of rights that such payment was "without prejudice" to its right to recover "the monies advanced against all responsible parties, including [Completion Contractor] and its surety company if appropriate."

The Owner ultimately demanded that Completion Contractor and its Surety return more than $ 1 million of the $2 Million paid above the $ 4.5 million GMP. When the Completion Contractor and Surety refused, the Owner sued.

In its lawsuit, the Owner claimed that the Completion Contractor was contractually required to finish the Project, including remedying "all deficiencies existing … at the time [Hayward] commenced work whether such deficiencies were latent or patent" within the $4.5 GMP. The Completion Contractor cross-claimed for breach of contract (asserting that the Owner had breached the implied warranties of the completeness and accuracy of the plans and specifications), rescission, and declaratory relief.

The trial court granted summary judgment to the Owner on a host of issues. Among other findings, the trial court held that the Completion Contractor's breach of contract claim for breach of the implied warranties was not viable because the claim was based on misrepresentation and the Completion Contractor had not pled facts

showing that any omissions in the plans and pre-punch lists "were actively concealed or that material information was intentionally omitted by" the Owner. As stated above, the Court of Appeal reversed the trial court's ruling and the issue currently on review before this Court is whether a contractor bringing a claim against a public agency based on the theory of breach of implied warranty must prove intentional concealment of material facts.

ARGUMENT

Requiring a contractor to prove intentional concealment of material facts in a claim for Breach of Implied Warranty against a public agency goes against the well-established principles set forth in *United States v. Spearin* (1918) 248 U.S. 132, the enactment of California Public Contract Code § 1104, and public policy interests.

I. In an action for Breach of Implied Warranty, any requirement that a contractor must prove material facts were intentionally concealed goes against the longstanding doctrine established by the seminal case of *United States v. Spearin* (1918) 248 U.S. 132 and its progeny.

The seminal case of *United States v. Spearin* (1918) 248 U.S. 132 has served as the cornerstone of construction law for over 80 years and stands for the principle that the government impliedly warrants the adequacy of the plans and specifications on a construction project. (*The Construction Lawyer* (Summer 2008) 28 Constr. Lawyer 25.) In coming to the decision in *United States v. Spearin*, Justice Brandeis reasoned that "if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in

the plans and specifications" and further that "the responsibility of the owner is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work." (*Ibid*.)

This ideology has transformed itself over the years into what many simply refer to as the Spearin Doctrine. As the Spearin Doctrine enables contractors to assume that the plans and specifications provided to them by the owner of a project are adequate and accurate, this serves to reduce the overall cost of construction by relieving contractors of the cost of independently verifying the adequacy and accuracy of such specifications. (*Ibid*.)

Thus, the Spearin Doctrine places responsibility for the correctness of plans and specifications where it logically belongs: on the owner. In the situation of a 'design-bid-build' project, the public agency is the party that stands in the optimal position to ensure that if a contractor builds per the plans and specifications given to them, the resulting work will be correct.

Any requirement that an owner must have engaged in an affirmative misrepresentation or intentional non-disclosure of a material fact in order for a contractor to properly bring a Breach of Implied Warranty claim essentially vitiates the central concept contained within the Spearin Doctrine – that the plans and specifications as provided by the owner is warranted as accurate. Being required to prove that material facts were intentionally concealed by the owner will only cause contractors to constantly question the accuracy of plans and specifications, thereby lending to a direct increase in the overall costs of construction as contractors will

now be forced to independently verify the accuracy and correctness of the plans and specifications provided to them.

II. The legislative intent behind the enactment of and recent proposed amendment to California Pub. Contract Code § 1104 does not support the notion that maintaining a cause of action for Breach of Implied Warranty requires the showing of an affirmative misrepresentation or intentional non-disclosure of material fact.

California Pub. Contract Code § 1104 provides as follows;

> "No local public entity, charter city, or charter county shall require a bidder to assume responsibility for the completeness and accuracy of architectural or engineering plans and specifications on public works projects, except on clearly designated design build projects. Nothing in this section shall be construed to prohibit a local public entity, charter city, or charter county from requiring a bidder to review architectural or engineering plans and specifications prior to submission of a bid, and report any errors and omission noted by the contractor to the architect or owner. The review by the contractor shall be confined to the contractor's capacity as a contractor, and not as a licensed design professional."

Pub. Contract Code § 1104 was enacted in 1999 via Assembly Bill 1314 ("AB 1314") by the California Legislature in response to the recent trend at that time by local entities to utilize contract provisions to transfer design liability from architects to general contractors. (*Official California Legislative Information [Legislative Counsel of California]* < http://www.leginfo.ca.gov/pub/99-00/bill/asm/ab_1301-1350/ab_1314_cfa_19990908_174728_sen_floor.html> [as of April 14, 2009].) Supporting arguments to AB 1314 contended such contract provisions ran counter to the long-standing division of

responsibilities on construction projects which were formally recognized by the United States Supreme Court in *United States v. Spearin* (1918) 248 U.S. 132. (*Ibid*.) Any efforts to shift the design risk to contractors, other than on design-build contracts, were fundamentally inappropriate, unwarranted, and wasteful. (*Ibid*.)

Inherent within the purpose arising out of Pub. Contract Code § 1104 is, with respect to design-bid-build contracts, the notion that contractors would not be responsible for any defects or inaccuracies contained within the plans and specifications as a public agency is prohibited from passing along the risk of the accuracy of the plans and specifications to the contractor. Thus, the contractor takes the plans and specifications from the public agency as being correct.

It follows that in any subsequent action to recover against a public agency in which the accuracy of the plans and specifications are at issue, a contractor need only show that the plans themselves were inaccurate, nothing more. It would be illogical to require the contractor to also show that the public agency purposefully withheld pertinent information if the law provides for the public agency to warrant the plans as being accurate in the first place. If this were the case, such a required showing of intent in a Breach of Implied Warranty action would essentially call into question every purported 'warranty' of correctness of plans and specifications and serve only to invalidate the very nature of Pub. Contract Code § 1104.

Nevertheless, as there is no explicit language set forth in Pub. Contract Code § 1104 regarding the issue of the viability of an 'intentional concealment' requirement, a split of authority over this issue has developed in the California courts. As these cases have been

set forth in detail in the Opening, Answer, and Reply Briefs, the *Amicus Curiae* will only touch on the main points of certain legal decisions here.

The First Appellate District Court of Appeal in *Jasper Construction Inc. v. Foothill Junior College District of Santa Clara County* (1979) 91 Cal.App.3d 1 and the Sixth Appellate District Court of Appeal in *Thompson Pacific Construction, Inc. v. City of Sunnyvale* (2007) 155 Cal.App.4th 525, 551 essentially held that in an action for Breach of Implied Warranty, a contractor who submitted a low bid in reliance on incorrect plans and specifications must prove the public agency affirmatively misrepresented or concealed material facts which rendered the bid documents misleading, in order to recover for any extra work performed. Although *Jasper Construction Inc. v. Foothill Junior College District of Santa Clara County* is still considered good law as of the date of the filing of this Amicus Brief, the holding of that case was rendered long before Pub. Contract Code § 1104 was enacted. While the *Thompson Pacific Construction, Inc. v. City of Sunnyvale* matter was decided after the enactment of Pub. Contract Code § 1104 and was based on the rationale set forth in *Jasper Construction Inc. v. Foothill Junior College District of Santa Clara County*, the Sixth Appellate District reasoned that its holding was not in conflict with Pub. Contract Code § 1104 since § 1104 said "nothing about the contractor's burden to prove that the public entity breached the warranty." (*Thompson Pacific Construction, Inc. v. City of Sunnyvale, supra,* 155 Cal.App.4th at p. 553.) As discussed in further detail below, the Legislature sought to amend Pub. Contract

Code § 1104 to reflect the extent of the contractor's burden of proof in a Breach of Implied Warranty action.

However, the Third Appellate District Court in *Welch v. State of California* (1983) 139 Cal.App.3d 546, rightly rejected a requirement of affirmative misrepresentation or active concealment in a Breach of Implied Warranty claim because "it is well established that, in a tort context, the suppression of a fact by one … who gives information of other facts which are likely to mislead for want of communication of that fact …' is actionable." In such context, there is no requirement of proving an affirmative fraudulent intent to conceal. (*Ibid*.) The same premise applies logically to public construction contracts where liability is based on breach of an implied warranty instead of a tort theory. (*Ibid*.)

In order to rectify this conflict of authority that an owner's mere failure to disclose adequate specifications would be enough to substantiate a contractor's claim for Breach of Implied Warranty, the Legislature sought to amend Pub. Contract Code § 1104 in 2008 via Assembly Bill 983 ("AB 983") to provide, in part, that "nothing [in Pub. Contract Code § 1104] shall be construed to require a contractor to prove an affirmative or intentional misrepresentation or active concealment on the part of the local public entity, charter city or charter county that provides the plans and specifications." (*Official California Legislative Information [Legislative Counsel of California]* < http://www.leginfo.ca.gov/pub/07-08/bill/asm/ab_0951 1000/ab_983_cfa_20080514_101214_sen_comm.html > [as of April 14, 2009].)

Thus, in keeping in line with the rationale behind the enactment of Pub. Contract Code § 1104, AB 983 sought to correctly reflect the extent of a contractor and a public agency's duties with respect to the issuance of plans and specifications. The use of the term "shall" necessarily implies that a contractor will not be required to prove that a public agency intentionally withheld material facts from any plans and specifications provided to a contractor. In fact, on August 7, 2008, a motion to approve the amendment to Pub. Contract Code § 1104 was made on the assembly floor, to which such motion received 73 Ayes and 0 Noes. (*Official California Legislative Information [Legislative Counsel of California]* <http://www.leginfo.ca.gov/pub/07-08/bill/asm/ab_0951-1000/ab_983_vote_20080807_1103AM_asm_floor.html> [as of April 14, 2009].)

Although the Governor eventually vetoed AB 983, the Governor's reasoning for doing so was not based on any objection to the amendments being proposed by AB 983. The Governor returned AB 983 without his signature because:

> "This bill is premature. The California Supreme Court recently agreed to review the case, *Los Angeles Unified School District v. Great American Insurance Co., et al.*, that involves the issues raised by this bill. [The Governor] believe[s] it is prudent for the [C]ourt to rule on current law before making any unnecessary or ill-advised changes. For these reasons, [the Governor is] returning this bill without my signature." (*Official California Legislative Information [Legislative Counsel of California]* < http://www.leginfo.ca.gov/pub/07-08/bill/asm/ab_0951-1000/ab_983_vt_20080930.html> [as of April 14, 2009].)

Based on the Governor's veto message and the Legislature's intent to amend Pub. Contract Code § 1104 to reflect the principle that a contractor shall not be required to prove that a public agency acted with the intent to withhold material facts from any plans and specifications provided to a contractor, the weight of legislative and executive authority favors a finding here that a contractor bringing a claim against a public agency on a Breach of Implied Warranty Claim must not be required to prove intentional concealment of material facts.

III. It is sound public policy to sustain the Court of Appeal's ruling and find that a contractor bringing a claim against a public agency on a Breach of Implied Warranty Claim is not required to prove intentional concealment of material facts.

LAUSD suggests in their Opening Brief on the Merits, pgs. 21 through 26, that a ruling in line with the Court of Appeal will only serve to create unsound public policy. In reality, as will be discussed in further detail below, public policy considerations surrounding this issue are best served if a contractor is not required to prove intentional concealment of material facts when bringing a Breach of Implied Warranty Claim against a public agency.

A. The taxpaying public will suffer if contractors are required to show that a public agency intentionally concealed material facts.

If a contractor were required to prove that material facts were intentionally concealed by an owner, it will only cause contractors to question the accuracy of the plans and specifications being provided to them. There is nothing to prevent public agencies from engaging in

careless review of plans and specifications and 'unintentionally' omitting material facts when their liability hangs on the very ability of a contractor to prove the public agency's intent to withhold information. If contractors are left with having to second-guess the accuracy of the plans and specifications provided to them by a public agency and the resulting plans and specifications are indeed deficient, litigation will surely ensue in order to flush out any material facts that would have been pertinent when issuing a bid.

This will lead to a direct increase in the overall costs of construction as contractors will feel the need to independently verify the accuracy and correctness of the plans and specifications being provided to them, thereby causing an increase in bid amounts. Additionally, contractors will deem it necessary to place contingencies in their contracts to protect against any 'unintentional' non-disclosure of material fact. These contingencies and increases in costs of construction will only amplify the overcall cost of constructing public works projects. Of course, these increased costs will not be absorbed by the public agencies themselves but will be directly imputed to the California taxpayers.

B. Concepts of inherent fairness and equity place the public agency in the best position to warrant against the correctness of plans and specifications, and any failure to do so justifies the maintenance of a Breach of Implied Warranty claim, irrespective of 'intent.'

In requiring a contractor to prove intentional concealment of a material fact in a Breach of Implied Warranty claim, the contractor would have to step into the shoes of the public agency and ensure that

the plans and specifications are correct as issued. By attempting to guard against any 'unintentional' concealment of material fact by the public agency, the contractor will be placed in the unjust position of not only performing its duties, but the duty of the public agency to ensure that the plans and specifications are correct as issued. Yet, it is the public agency that is in the best position here, as between the design agency and the contractor, to inform the contractor of all material facts involved with the public works project to be constructed. To pass on such a responsibility to the contractor will essentially preclude the public agency from being responsible for producing accurate plans and specifications.

Therefore, in sustaining the decision of the Court of Appeal, the responsibility to provide accurate plans and specifications will be relegated to the proper party, here the public agency, and will give the contractor a remedy in the event the public agency fails to adhere to its duties. As public agencies are in the best position to warrant against the accuracy of the plans and specifications, any resulting inadequacies, inaccuracies, or non-disclosures, whether intentional or not, should be borne by the public agency themselves.

CONCLUSION

A contractor must not be required to prove intentional concealment of material facts when bringing a claim against a public agency based on Breach of Implied Warranty because to do so goes against the deep-rooted ideology set forth by the Spearin Doctrine that the plans and specifications provided to a contractor by the owner of a project are adequate and accurate. Further the California Legislature even took measures to amend California Public Contract Code § 1104

to clarify that a contractor need not prove that a public agency affirmatively or intentionally misrepresented plans and specifications. Moreover, public policy considerations involving the public's fiscal health as well as the principles of equity and fairness mandate the result requested by the *Amicus Curiae*.

Therefore, ASA and ASAC, on behalf of its members and as *Amicus Curiae* herein, respectfully requests that this Court sustain the decision of the Court of Appeal, Second Appellate District, Division Two and hold that a contractor bringing a claim against a public agency based on the theory of Breach of Implied Warranty is not required to prove intentional concealment of material facts.

Dated: April 30, 2009

Respectfully submitted,

LAW OFFICES OF
CRAWFORD & BANGS, LLP

E. SCOTT HOLBROOK, JR.
KELLY A. SZE
For the Firm
Attorneys for Amicus Curiae
AMERICAN
SUBCONTRACTORS
ASSOCIATION
and AMERICAN
SUBCONTRACTORS
ASSOCIATION
OF CALIFORNIA

CERTIFICATE OF COMPLIANCE

(California Rules of Court, rule 8.520(c)(1))

Counsel of record for the *Amicus Curiae* herein certifies that this Amicus Brief was produced using 14-point type and contains approximately 4,601 words. Counsel relies on the word count of the Microsoft Word program used to prepare this brief.

Dated: April 30, 2009

Respectfully submitted,

LAW OFFICES OF
CRAWFORD & BANGS, LLP

E. SCOTT HOLBROOK, JR.
KELLY A. SZE
For the Firm
Attorneys for Amicus Curiae
AMERICAN
SUBCONTRACTORS
ASSOCIATION
and AMERICAN
SUBCONTRACTORS
ASSOCIATION
OF CALIFORNIA