PUBLIC ENTITIES MAY BE HELD LIABLE FOR FAILING TO DISCLOSE MATERIAL INFORMATION TO BIDDERS EVEN WITHOUT FRAUDULENT INTENT

By David B. Kuhlman, Esq.
Procopio, Cory, Hargreaves & Savitch LLP

The California Supreme Court recently expanded the circumstances in which a public works contractor may recover its extra costs of performance from a public entity that does not disclose material information during the bidding process. In so doing, however, the Court stressed that contractors will not be relieved from the consequences of their own careless bidding practices. As a result, both public entities and public works contractors must continue to proceed very cautiously during the bidding process.

In *Los Angeles Unified School District v. Great American Insurance Company*, the Los Angeles Unified School District ("District") entered into a contract with Lewis Jorge Construction Management, Inc. ("Lewis Jorge") to construct an elementary school according to plans and specifications the District provided. A few years later, the District declared Lewis Jorge to be in default and terminated the contract. The District then solicited bids for the completion of the project and provided bidders with not only the original plans and specifications, but also a 108-page "corrections list" describing work of the first contractor that the District's inspectors and consultants found to be defective, incomplete, or missing.

After receiving the plans, specifications, and corrections list, and after conducting a site inspection, Hayward Construction Company ("Hayward") submitted a proposal to do the work on a time and materials

DAVID B. KUHLMAN

basis with a guaranteed maximum price of $4.5 million. The District accepted Hayward's bid and the parties entered into a contract that obligated Hayward, among other things, "to correct deficiencies in the work performed by the former contractor, without limitation, as noted on the current correction list issued by the District."

Shortly after beginning work, Hayward notified the District it had significantly underestimated the costs of the remedial work due to deficiencies that were not noted on the correction list and could not have been discovered by simple observation. Hayward asked for extra compensation of approximately $2.8 million. The District disputed that Hayward was entitled to any sum over the $4.5 million guaranteed maximum price, but paid Hayward an extra $1 million under a reservation of its right to take action to recover the additional compensation. The District then filed a complaint against Hayward and its surety, and Hayward filed a cross-complaint against the District to recover its additional costs of performance.

In its cross-complaint, Hayward alleged that the District failed to disclose the full nature and extent of the defects in the existing construction, and 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 (such as a consultant's report that would have alerted Hayward to defects in the stucco work). Hayward did <u>not</u> contend that its bid was in any way affected by any misrepresentation or omission in the plans and specifications the District provided. In other words, Hayward's claim against the District was based solely on the District's failure to disclose other, material information about the required work.

The trial court, following the decision in *Jasper Construction, Inc. v. Foothill Junior College Dist.*, ruled in favor of the District on the basis that Hayward could not recover without alleging that the District had actively concealed or intentionally omitted material information (in other words, acted in some fraudulent manner). The Court of Appeal, however, reversed the judgment of the trial court, and held that Hayward could maintain its action if it could establish that the "District knew material facts concerning the project that would affect Hayward's bid or performance and failed to disclose those facts to Hayward."

The District appealed to the California Supreme Court, which initially noted the conflicting California law on the liability of public entities for non-disclosure of material information to bidders. After an extensive analysis, the Supreme Court disapproved the holding in *Jasper*, *supra*, that a contractor must prove active

Copyright @2010 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

misrepresentation or fraudulent concealment on the part of the public entity in order to recover. Instead, the Supreme Court essentially adopted the "superior knowledge doctrine" long applied by the federal courts, and held that a 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 Supreme Court stressed that despite its ruling, contractors will not be permitted to recover for their own careless bidding practices, and that public entities will not be held liable for failing to disclose information that a reasonable contractor should have discovered on its own. The Court also gave guidance to future parties by listing a number of circumstances that can affect the contractor's right to recovery, including, but 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."

In summary, the Supreme Court made it easier for a public works contractor to prevail in a non-disclosure case against a public entity by removing the requirement that the contractor prove the public entity affirmatively misrepresented or actively concealed material information. To this extent, in preparing and issuing bid documents, public entities must exercise great caution to include all information of which they are aware that could in any way materially affect the contractor's bid price. By the same token, contractors must still be very diligent during the bidding process to not only carefully study the information furnished by the public entity, but also to inspect the job site and use reasonable efforts to obtain any other available information that could affect their bid. In short, the bidding process will continue to be a critical time during which both sides must truly "be on their toes."

For more than 25 years Mr. Kuhlman's practice has focused on serving the construction industry, representing owners, developers, builders, and design professionals in every phase of private and public construction, from initial planning through dispute resolution. He practices extensively on the transactional side, where he has structured, negotiated and drafted design and construction contracts for large projects throughout California and in the southwestern United States. Reach him at 619.515.3261 or david.kuhlman@procopio.com.

Copyright @2010 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.