

# Construction & Infrastructure Law Blog

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## [Contractors Can Recover for Public Agency's Failure to Disclose Material Information](#)

In a recent decision the California Supreme Court expanded the implied warranty of specification suitability to include claims for a public agency's failure to disclose material information. In doing so it resolved a split in the decisions of the lower appellate courts. Notably, the Court adopts virtually the same rationale recognized by the Federal Circuit and Court of Federal Claims on federal procurement contracts, namely, the "superior knowledge" doctrine. In *Los Angeles Unified School Dist. v. Great American Ins.*, 49 Cal. 4th 738, 2010 WL 2720825 (July 12, 2010), the Court held that a contractor need not prove intentional misrepresentation to recover compensation for a public entity's failure to disclose material information. The Court expressly disapproved *Jasper Construction v. Foothill Junior College*, (1979) 91 Cal. App. 3d 1, which held to the contrary.

Under *Los Angeles Unified*, recovery is qualified by a four-part test. A contractor may recover from a public entity where: (1) the contractor submitted its bid or undertook to perform without material information that affected 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, the information, (3) any contract specifications or information furnished by the public entity misled the contractor or did not put it on notice to inquire, and (4) the public entity did not provide the relevant information. *Id.*

### **Background**

The underlying facts of *Los Angeles Unified* are straightforward. In 1996, the Los Angeles Unified School District contracted to build an elementary school. Three years later, the District terminated the construction contract declaring the contractor to be in material breach and default. The District then sought bids from contractors, including the plaintiff, to complete the project and repair defects in the existing construction. The plans and specifications available to bidders indicated that the contractor selected would be responsible for both listed and unlisted defects in the "correction list" or "pre-punchlist". After receiving the plans and conducting a site inspection, the plaintiff contractor submitted the winning bid to complete the work for \$4.5 million.

Shortly after construction commenced, the contractor discovered defects more extensive than originally presumed. The contractor noted that the existing work had nonconformities that could

not have been detected by simple observation and were not indicated in the correction list. For example, the repair of some stucco surfaces would have required replacing not only the stucco, but the underlying exterior wall and material at a greatly increased cost. The contractor sought extra compensation for work necessitated by what it termed "latent defects". The contractor alleged the District had breached the contract by misrepresenting the material facts and conditions of the project, and further, had breached the implied warranty that the plans were a complete and accurate depiction of the project's scope. As an example, the contractor alleged that the District had failed to disclose a consultant's report that would have indicated more significant defects in the existing construction.

The trial court granted the District's motions for summary adjudication and judgment on the pleadings, holding that the contractor had failed to recite facts indicating the District had intentionally concealed information. The California Court of Appeals reversed, reasoning that the contractor could maintain an action for breach of contract if the District "knew material facts concerning the project that would affect [the contractor's] bid or performance and failed to disclose those facts." *Los Angeles Unified School Dist. v. Great American Ins.* (2008), 163 Cal. App. 4th 944, 965.

### **Courts of Appeal Split**

The Court's opinion in *Los Angeles Unified* began by affirming the measure of public entity liability set forth by the U.S. Supreme Court in *Spearin v. U.S.* (1918), 248 U.S. 132. The *Spearin* Court held that plans and specifications presented by a public entity were impliedly warranted to be correct. Under *Spearin*, a contractor can recover for an unanticipated increase in cost if this warranty was breached. The California Supreme Court clarified the application of this doctrine in *Souza & McCue Const. Co. v. Superior Court* (1962), 57 Cal. 2d 508, holding that:

"[a] contractor of public works who, acting reasonably, is misled by incorrect plans and specifications issued by the public authorities as the basis for bids and who, as a result, submits a bid which is lower than he would have otherwise made may recover in a contract action for extra work or expenses necessitated by the conditions being other than as represented."

Opposing opinions grew out of the California Courts of Appeal in applying this principle to situations where the plans and specifications were correct, but the contractor was misled as a result of material information unintentionally withheld by the public entity. *Los Angeles Unified* aimed to resolve these conflicting opinions, which are briefly considered below.

- ***Jasper Construction v. Foothill Junior College***

In *Jasper* (1979), 91 Cal. App. 3d 1, a contractor claimed that as a result of inadequate and defective plans for the construction of a school auditorium, it incurred delays and extra expenses. The plans, the contractor claimed, required the contractor to pour concrete by a "wall-to-wall"

method, instead of a customary "floor-to-floor" method. The Court of Appeals dismissed the contractors claim against the school district. The Court, applying *Souza*, held that recovery in a contract action by a contractor of public works is only available where the contractor is misled by incorrect plans and specifications. The application of this rule turned on the definition of *misrepresentation*, an act requiring some affirmative act. Anything less than a positive act, reasoned the Court, would expose public entities to liability for contractors' lack of diligence in examining plans and specifications.

- ***Welch v. State of California***

In *Welch* (1983), 139 Cal. App. 3d 546, a contractor alleged it was misled by the state's failure to disclose information in its possession about similar repairs performed on the site ten years earlier. The Court held that "under certain circumstances, a governmental agency may be liable for failing to impart its knowledge of difficulties to be encountered in a construction project". It found that the state had a duty to disclose information about a prior repair if disclosure would eliminate or materially qualify the misleading effect of the plans and specifications.

- ***Thompson Pacific Const. v. City of Sunnyvale***

*Thompson Pacific Const.* (2007), 155 Cal. App. 4th 525, involved a claim by contractor against a city who refused to increase the contract price for the construction of a senior center due to alleged non-conforming construction. Approving of the principle in *Welch*, the Court noted that "careless failure to disclose information may form the basis for an implied warranty claim if the defendant possess superior knowledge inaccessible to the contractor." *Id.* at 552. However, the Court also pointed out that *Welch* was consistent with the general rule that "silence is not actionable." *Id.*

In *Los Angeles Unified*, the California Supreme Court attempted to strike a balance between the appellate decisions in *Welch* and *Thompson*, that preserved a contractor's cause of action against public entities who unintentionally fail to disclose material facts. The Court expressly rejected *Jasper*, which held that there must be an affirmative misrepresentation or concealment of fact in order for the contractor to recover.

### **Adoption of the "Superior Knowledge Doctrine"**

In rejecting *Jasper*, the Court spent little time distinguishing the holding of *Jasper* itself, relying on other authority to disapprove the opinion that recovery by a contractor must be premised on the affirmative act of misrepresentation. First, Justice Werdegar pointed to California authority upholding judgments against owners for active concealment of material facts. For example, in *City of Salinas v. Souza & McCue Const. Co.*, (1967) 66 Cal. 2d 21, 222-223, the Court of Appeals found a city had affirmatively concealed facts, and further noted that a general rule that "by failing to impart its knowledge of difficulties to be encountered in a project, the owner will be liable for misrepresentation if the contractor is unable to perform." In *unintentional* concealment cases, like *Welch* and *Thompson*, this principle was affirmed where disclosure would have materially qualified the misleading effect of the plans and specifications.

Second, in forming its test for liability, the Court drew on the "superior knowledge doctrine" put forth by the U.S. Court of Claims in *Helene Curtis Indus. v. U.S.* (Ct.Cl. 1963), 312 F.2d 774. In *Helene Curtis*, the Court found that the U.S. Army possessed "superior knowledge" that would have alerted bidders to the project's true requirements. The Court held that the *Spearin* doctrine applied. It reasoned that where a public agency "possess[es] vital information which it was aware the bidders needed but would not have, [it] could not properly let them flounder on their own." *Id.* at 778. The *Los Angeles Unified* court thereafter adopted the test articulated by *Helene Curtis* allowing relief where: (1) a contractor undertakes to perform without vital information or knowledge of a fact that affects performance costs or duration, (2) the public entity was aware the contractor had no knowledge of and had no reason to obtain such information, (3) the contract specifications misled the contractor or did not put it on notice to inquire, and (4) the public entity failed to provide the relevant information. *Los Angeles Unified*, 2010 WL 2720825 at 7.

### **Application of the "Superior Knowledge Doctrine"**

The opinion in *Los Angeles Unified* highlights the Court's reliance on the "superior knowledge doctrine" to actions for unintentional misrepresentation. *Helene Curtis* is factually distinguishable from *Los Angeles Unified*. In *Helene Curtis*, the U.S. Army requested a disinfectant composed of a new chemical that it knew needed more processing than revealed in the "skimpy" specifications. 312 F.2d at 775. The Court found that withholding information of this nature may constitute a breach of "an independent duty to reveal data" if it "embodies material misrepresentation misleading the contractor." *Helene Curtis*, 312 F.2d at 778. In *Los Angeles Unified*, the specifications indicated that the contractor awarded the job would also be responsible for unlisted defects in existing construction and indicated that defects listed were for general review only. Whereas the U.S. Army sought to withhold information *essential* to the cost-effective manufacture of the disinfectant in *Helene Curtis*, the plans and specifications in *Los Angeles Unified* expressly stated that further defects may exist in the project. Nevertheless, the Court found the superior knowledge of the public agency determinative.

Further, the test articulated in *Helene Curtis*, and adopted by *Los Angeles Unified*, relies on the assumption that the public entity *knows* that the information it possesses may materially affect the contractor's bid or performance on the contract. Similarly, the second element of the test prescribed by *Los Angeles Unified*, requiring the "public entity was in possession of the information and was aware the contractor had no knowledge of [the information]", appears to make the same assumption. *Los Angeles Unified*, 2010 WL 2720825, at \*7. How will the finder of fact evaluate a public agency's knowledge of materiality?

### **Totality Of The Circumstances**

In practice, the public agency's knowledge that certain information was material and that the contractor had no knowledge of it would likely be proved by direct testimony and circumstantial evidence. On this point the Superior Court noted that any finding of liability for unintentional misrepresentation would be based on the "totality of the circumstances". The circumstances affecting recovery may include: (1) positive warranties or disclaimers made by either party, (2) the information provided by the plans and specifications and related documents, (3) the difficulty

of detecting the condition in question, (4) any time constraints the public entity imposed on proposed bidders, and (5) any unwarranted assumptions made by the contractor. As a result, a "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." *Los Angeles Unified*, 2010 WL 2720825, at \*7.

## **Conclusion**

*Los Angeles Unified* resolves a split in the Courts of Appeal regarding the liability of public entities for unintentional misrepresentation of material facts to contractors during the bidding process. Practitioners will be paying close attention to the trial court as it applies the *Los Angeles Unified* ruling on remand. The ultimate judgment will provide the first indication of how trial courts will apply this new liability regime moving forward.

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