

# CA Supreme Court Clarifies Rule on Contractor Claims

By Alan Wilhelmy



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**In limited circumstances** a contractor is no longer required to prove intentional misrepresentation or active concealment by a public agency to recover additional costs of performance.

The California Supreme Court recently issued its opinion in *Los Angeles Unified School District vs. Great American Insurance* 49 Cal. 4th 739 (2010) (“LAUSD”) to resolve conflicts in several court of appeal opinions addressing the right of a contractor to recover the additional costs of performance where material information that affects the performance of the work is not disclosed by a public agency. The concept that there is an implied warranty by the public agency of the correctness of the agency’s plans and specifications developed over the years and is reflected in both state court opinions such as *A. Tiechert & Son Inc. v. State of California* (1965) 238 C.A. 2d 736 and *E. H. Morrill Co. v. State of California* (1967) 65 Cal.2d 787, and in the seminal United States Supreme Court case of *United States v. Spearin* (1918) 248 U.S. 132. Those cases provide that unanticipated difficulty in the work is not sufficient to justify additional compensation. LAUSD addressed the case where the plans were accurate but other information was not disclosed by the agency.

Several California courts of appeal and the State’s Supreme Court have grappled with the issue over the years and have held the contractor to different standards with respect to what the contractor must prove to recover from a public agency.

In *Souza & McCue Constr. Co. v. Superior Court* (1962) 57 Cal.2d 508, the California Supreme Court ruled that nondisclosure combined with active concealment by the public agency is required to support a cause of action for misrepresentation. In *Souza*, the City’s chief engineer knew of highly unstable soils in portions of the project and directed the City’s consultant to perform limited testing that excluded the problem areas. The report that was generated was furnished to bidders who relied upon it.

stances in which a contractor may have a cause of action in contract for the non-disclosure by a public agency:

1. The public agency makes representations but fails to disclose facts which render the statement likely to mislead.
2. The facts are known only to the agency and the agency knows this and they are not reasonably discoverable; and;
3. There is active concealment by the agency.

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*It is typically very difficult to prove intentional misrepresentation or active concealment, and as a result the burden upon contractors in establishing claims against public agencies is relieved to some extent by the LAUSD decision.*

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*Wunderlich v. State of California* (1967) 65 Cal.2d 777 involved a report for a Caltrans project that expressed opinions as to the varied quality of materials to be found in a borrow pit. The court held that there was no misrepresentation by the state, that both parties had access to the same information, and that the contractor had made incorrect assumptions about the quality of the available fill material.

In *Warner Constr. Corp. v. City of Los Angeles* (1970) 2 Cal.3d 285, the California Supreme Court held that a contractor retains a cause of action for breach of contract even though it may not have a cause of action for fraudulent misrepresentation or for quantum meruit. In *Warner*, erroneous boring information was furnished to bidders. The court held that a public agency must disclose knowledge it has of difficulties that are expected to be encountered in the construction. The court identified three in-

In *Jasper Construction, Inc. v. Foothill Junior College Dist.* (1979) 91 Cal. App. 3d 1, the court of appeal held that the contractor must establish active concealment or intentional omission of material information.

In *Welch v. State of California* (1983) 139 Cal. App. 3d 546, the court held that nondisclosure alone may support an award without intentional misrepresentation or active concealment. *Welch* involved incorrect tide information published by Caltrans in connection with a bridge repair project. The court explained that the decision in *Warner* made it clear that liability may be imposed even in the absence of an intentional failure to disclose when the disclosure would have eliminated or materially qualified the misleading effect of the agency’s misrepresentation.

Finally, in *Thompson Pacific Construction, Inc. v. City of Sunnyvale* (2007) 155 Cal.

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*App.4th 525* the court of appeal held that negligent failure to disclose information may provide the basis for recovery if the public agency possessed superior knowledge that was inaccessible to the contractor.

In *LAUSD* the court backed away from the Jasper active concealment or intentional omission rule to a limited extent.

Under *LAUSD* the Court held that a contractor may recover the additional cost of performance due to the nondisclosure of a public agency if the contractor was acting reasonably and it is misled by the plans and specifications and it is able to satisfy a four part test:

1. The bid was submitted without material information that affected the cost of performance.
2. The public agency had the information and knew that the contractor did not.
3. The information furnished actually misled the contractor, and did not put the contractor on notice to inquire, and;
4. The agency failed to furnish the information.

Under *LAUSD*, the contractor is now

not required to show active concealment or intentional omission. In *LAUSD* the school district owner terminated its first contractor and then contracted with Hayward Construction to remedy defects in the original contractor's work and to complete the project.

Hayward's allegations were that the school district had knowledge of the methods Hayward intended to use based upon its bid. The district had a consultant's report that, had it been disclosed by the district, would have alerted the contractor to latent defects in the prior contractor's unfinished work. The trial court granted summary judgment against the contractor under Jasper concluding that the contractor had not alleged facts showing active concealment or intentional omission of material information by the district.

The court of appeal reversed the trial court ruling, holding that the contractor could maintain a cause of action based upon the allegation that the district had knowledge of material facts that affected the contractor's bid or the cost of performance. The Supreme Court noted that it was necessary to decide whether a contractor may recover when the plans and specifications are correct but the public agency failed to disclose information in

its possession that materially affected the cost of performance. The Court agreed with the court of appeal that active concealment or intentional omission of material information is not required but then held that the court of appeal was overbroad in concluding that a contractor may recover based upon any failure to disclose material information. The Court then set forth the four part test. The Court also cautioned that contractors still have a duty to exercise reasonable diligence to discover conditions and information that may affect the cost of the performance of the work.

The *LAUSD* ruling looks in part similar to the *Thompson Pacific* superior knowledge test and in that regard presents a lower standard of proof for contractors. It is typically very difficult to prove intentional misrepresentation or active concealment, and as a result the burden upon contractors in establishing claims against public agencies is relieved to some extent by the *LAUSD* decision. 🧐

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