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S165113

**IN THE SUPREME COURT
OF THE
STATE OF CALIFORNIA**

LOS ANGELES UNIFIED SCHOOL DISTRICT,
Plaintiff and Respondent,

v.

GREAT AMERICAN INSURANCE COMPANY, et al.,
Defendants and Appellants.

After A Decision By The Court Of Appeal
Second Appellate District, Division Two
Case No. B189133

OPENING BRIEF ON THE MERITS

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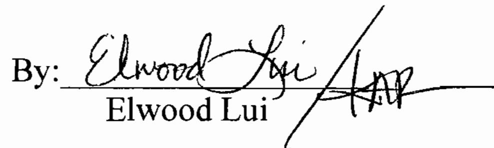
CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

Pursuant to Rule 8.208(c)(2) of the California Rules of Court and Section IV, paragraph L of this Court's Internal Operating Practices and Procedures, Respondent Los Angeles Unified School District is exempt from filing a certificate of interested entities or persons.

Dated: December 1, 2008

Respectfully submitted,

JONES DAY



By: Elwood Lui

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INTRODUCTION

This case presents an issue of paramount importance to the future of public works construction projects in California and the taxpayers who fund them: Whether a public entity must pay a contractor for cost overruns beyond the agreed-upon contract price under a nondisclosure, breach of implied warranty theory when there is admittedly no evidence the public entity intentionally concealed or misrepresented material information about the project, or had any intent to defraud. The Court of Appeal in this case reversed the trial court on this issue and erroneously held that a contractor need not prove intentional concealment or affirmative misrepresentation, but can force a public entity to pay for a contractor's cost overruns simply by showing there was nondisclosure of a fact that the contractor later deems material. The court's ruling substantially and unjustifiably broadens the scope of liability public entities face when entering into construction contracts for public works projects, and in the process establishes unsound public policy.

In this case, a contractor refused to pay for costs exceeding the contract price to complete construction of an elementary school for the Los Angeles Unified School District ("School District"). This contractor was hired as a completion contractor and knew it would be completing and correcting the work of a prior contractor who was in default and whose construction was defective and deficient in many respects. Despite that the completion contractor knew these facts and admittedly had open access to inspect the construction site, it nonetheless sought millions of dollars above the already agreed-upon multi-million dollar contract price based upon purported "latent" defects discovered at the project site associated with the original contractor's work. Significantly, the trial court found, and the Court of Appeal acknowledged, that the completion contractor admitted "it

neither possesse[d] nor [was] aware of any evidence of affirmative misrepresentation or intentional concealment" the School District made about the project. (*Los Angeles Unified School District v. Great American Insurance Co.* (2008) 163 Cal.App.4th 944, 964.) In its sweeping and unprecedented ruling, the Court of Appeal misread the case of *Welch v. State of California* (1983) 139 Cal.App. 3d 546, which, contrary to the court's conclusion, can be reconciled with the long line of authority requiring proof of some affirmative misrepresentation or fraudulent concealment by a public entity in order to maintain a contract action for breach of the implied warranty based on nondisclosure. (See, e.g., *Thompson Pacific Construction, Inc. v. City of Sunnyville* (2007) 155 Cal.App.4th 525, 551; *Jasper Construction, Inc. v. Foothill Junior College Dist. of Santa Clara County* (1979) 91 Cal.App.3d 1,10; *Warner Construction Corp. v. City of Los Angeles* (1970) 2 Cal.3d 285, 293-295; *Wunderlich v. State of California ex rel. Dept. of Public Works* (1967) 65 Cal.2d 777, 783; *Souza & McCue Construction Co. v. Superior Court* (1962) 57 Cal.2d 508, 510.)

The Court of Appeal applied a standard for recovery that is tantamount to strict liability for public entities and is inconsistent with this Court's precedent and other appellate authority of this State, including cases applying like principles in tort law. Indeed, the School District is aware of *no* case that applies a standard like that adopted by the Court of Appeal. Allowing the court's decision to stand risks (i) undermining the competitive bidding statutes applicable to public construction contracts, which place unique constraints on public agencies that do not exist in the private construction arena; (ii) saddling public agencies with the financial repercussions of a contractor's lack of diligence in obtaining necessary and complete project information, thereby forcing the agencies to act as "insurers" for a contractor's asserted cost overruns; (iii) impeding the

ability of public agencies to effectively budget for public works projects; (iv) demanding even the smallest of school districts, as well as other public entities, to spend money defending expensive and protracted breach of warranty disputes—thereby diverting scarce financial resources away from much needed public works projects vital to the continued development of California's infrastructure—even where there is no evidence of wrongdoing; and (v) requiring public agencies to develop the same expert knowledge ostensibly held by the contractor, insofar as the agencies will become obligated to discern what information a contractor may deem "material" to a given project. All of this, despite the contractor's specific execution of a contract and opportunity to investigate the worksite of a project for which the contractor voluntarily and knowingly agreed to perform the work subject to a guaranteed maximum price.

In light of these pressing legal and policy concerns, this Court should reverse the appellate court's ruling and hold that a contractor *cannot* maintain a contract action for breach of implied warranty based on nondisclosure absent a showing that the public agency affirmatively misrepresented or actively concealed material information. To rule otherwise would unjustifiably overrule long-standing precedent, create unsound public policy, and undermine the well-established principle repeatedly upheld by this Court that laws governing public construction contracts have been enacted and implemented "for the benefit of property holders and taxpayers, and *not* for the benefit or enrichment of bidders, and should be so construed and administered as to accomplish such purpose fairly and reasonably *with sole reference to the public interest*." (*Amelco Electric v. City of Thousand Oaks* (2002) 27 Cal.4th 228, 239 [citing *Kajima/Ray Wilson v. Los Angeles County Metropolitan Transportation Authority* (2000) 23 Cal.4th 305, 316], emphasis added.)

FACTUAL AND PROCEDURAL BACKGROUND

I. School District Contracts to Erect an Elementary School

In March 1996, following competitive bids required by statute, the Los Angeles Unified School District contracted with Lewis Jorge Construction Management, Inc. ("LJCM") to build an elementary school, the Queen Anne Place Elementary School (the "Project"), for approximately $10.1 million. (3 HA 0761-0778.)[1] By late 1998, the School District had become dissatisfied with LJCM's performance, and therefore declared LJCM to be in material breach and default. (1 HA 0060, 0067; 2 DA 0263-0264.)[2] The School District determined at the time that approximately 93 percent of the contract work had been completed, though defects and deficiencies in the work existed. (2 DA 0263; 1 HA 0204.) As a result of LJCM's default, the School District terminated LJCM's right to proceed with the Project and called upon LJCM's performance bond surety to perform, which it refused to do. (See 1 HA 0067; 3 HA 0767, ¶ 16.)

II. School District Enters Into a Completion Contract

Following the combined failures of LJCM and its surety, the School District, in May 1999, searched for a contractor to complete the Project in accordance with the original plans and specifications. (1 HA 0060, 0067.) In addition to carrying out the remaining construction, completion of the Project required correcting LJCM's defective work, some of which was then known. (*Ibid.*) This completion contract was an extension of the competitively bid contract the School District executed with LJCM and, to the extent necessary, was authorized by an emergency declaration provision of the Public Contract Code. (1 HA 0060; 2 DA 0267-0269.)

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[1] "HA" refers to Hayward Construction Co.'s Appendix on appeal.

[2] "DA" refers to the School District's Appendix on appeal.

To enable those contractors interested in completing the Project to compete for the job, the School District provided them with a non-exhaustive, 108-page corrective list (also referred to as a "pre-punch list") that identified some of the work that needed to be done. (1 HA 0229-0265.) The School District explicitly described the "pre-punch list" as a courtesy list only, and warned bidders that they should not read it as a final punch list. (1 HA 0229-0265.) The School District also provided the contractors open access to the construction site so they could inspect the property and raise any concerns they had before bidding on the Project. (1 HA 108:18; Appellant's Opening Brief ("App. Op. Br."), at p.10 ["the District provided . . . access to the site"].)

Following the receipt of contractor bids, the School District selected Hayward Construction Company Inc. ("Hayward") to complete the Project. In June 1999, Hayward and the School District entered into a Completion Contract for Queen Anne Place Elementary School ("Completion Contract"). (1 HA 0067-0080.) A copy of the pre-punch list accompanied the Completion Contract. (1 HA 0029-0265.) Absent precise knowledge of the remaining work to be done, the parties entered a "time and materials" contract subject to a guaranteed maximum price of $4.5 million. (1 HA 0069-0072.) Hayward was to be paid based on time and materials basis, plus a percentage profit added to its costs. (*Ibid.*) Under the terms of the Completion Contract, Hayward agreed to furnish all labor, services, equipment, and/or materials necessary to complete the Project. (1 HA 0068.) Hayward also agreed to "correct deficiencies in the work performed by the former contractor, *without limitation*," as indicated in the pre-punch list. (1 HA 0074, emphasis added.) As noted, the parties settled on a guaranteed maximum price to the School District of $4.5 million. (1 HA 0072.)

Although never before seeking change orders for its work, upon reaching the $4.5 million maximum Hayward asserted that latent defects existed that were outside the Completion Contract's scope, and threatened not to complete the Project unless the School District paid millions of dollars more than the agreed-upon maximum contract price. Under a reservation of rights, the School District advanced additional funds (approximately $1.5 million) and Hayward completed the Project. (1 GAA 0204-0205.)[3]

III. Litigation Ensues Between the School District and Hayward/Great American for Breach of Contract and Performance Bond

In March 2001, the School District filed its complaint against both Hayward and its performance bond surety Great American Insurance Company ("Insurance Company"). (1 HA 0058.) Hayward cross-complained against the School District in May of that same year. (1 HA 0106.) Among other allegations, both the School District and Hayward claimed the other had breached the Completion Contract.

There were then a number of motions and rulings by the trial court unrelated to the implied warranty issue here, which are detailed in the Court of Appeal's decision. As for the implied warranty issue, beginning in June 2004, the parties briefed Hayward's claim for breach of implied warranty regarding the School District's plans and specifications for the Project. (5 HA 1123-1140.) On September 1, 2004, the trial court ruled in the School District's favor, concluding that whether the School District breached the implied warranty "requires an intentional non-disclosure or affirmative misrepresentation regarding the plans and hence is identical to the claim of breach of contract based upon affirmative misrepresentation and/or

[3] "GAA" refers to Great American Ins. Co.'s Appendix on appeal.

intentional non-disclosure . . . ." (5 HA 1141.) As noted in the Court of Appeal's decision, the trial court found that Hayward admitted that the School District had neither affirmatively misrepresented nor actively concealed from Hayward any information about the project. (*Great American, supra*, 163 Cal.App.4th at p. 964; see 4 HA 1075-1078.)

Outstanding issues pertaining to Hayward's and the Insurance Company's affirmative defenses were adjudicated in the School District's favor in November 2004 and November 2005, respectively. Judgment was thereafter entered on December 19, 2005. (5 HA 1163, 1198.) Both Hayward and the Insurance Company appealed.

IV. The Court of Appeal Reverses the Trial Court on the Claim for Breach of Implied Warranty of Correctness, Holding that Neither Intentional Nondisclosure Nor Affirmative Misrepresentation is Required

On appeal, the court reversed almost entirely the trial court's judgment, affirming only the order determining that the Completion Contract was not illegal. (*Great American Ins. Co., supra*, 163 Cal.App.4th at pp. 967-969.) Importantly for purposes of this Court's review, the Court of Appeal stated that "[t]here is a conflict in 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." (*Id.* at p. 964, citation omitted.) The Court of Appeal adopted a standard least protective of public agencies—imposing liability for breach of implied warranty even in the absence of either intentional nondisclosure or affirmative misrepresentation. (*Id.* at pp. 964-966.) Under the Court of Appeal's standard a contractor need only establish that the public entity knew (i.e., possessed) material facts concerning the project that would affect the contractor's bid or performance, and which the public agency failed to disclose. (*Ibid.*) Notably, the Court of Appeal did not—and could

not, given the evidence of Hayward's admission—disagree with the trial court's determination that there was no affirmative misrepresentation or active concealment involved in this case. (*Id.* at p. 964 ["The trial court further noted that Hayward admitted in deposition that it neither possesses nor is aware of any evidence of such affirmative misrepresentation or intentional concealment."].) In other words, the Court of Appeal would impose liability and the costs of further litigation in circumstances where the undisputed evidence establishes no wrongdoing by the public agency.

ARGUMENT

I. Requiring Proof of Affirmative Misrepresentation or Intentional Concealment To Prevail on a Breach of Implied Warranty Claim is Consistent with Decisional Law of This Court

A. Cases Involving Public Construction Contracts Uniformly Turn on the Presence of Affirmative Wrongdoing

Over time, this Court has set down several common sense principles that warrant consideration when determining the scope of liability a public entity should face when a contractor claims it is entitled to more than the contract price for construction difficulties it did not anticipate. For example, in *Souza & McCue Construction Co.*, this Court first made clear 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 represented." (57 Cal.2d at p.510, emphasis added.) Because the public entity in that case was alleged to have knowingly omitted information regarding adverse soil conditions from the project's plans and specifications, the Court held the contractor stated causes of action against the public entity "in contract

on the basis of the alleged *fraudulent breach*" by the entity. (*Id.* at p. 511, emphasis added.)

This Court later expanded on the principle laid down in *Souza* by determining that a public entity is not liable for breach of the implied warranty of correctness absent some wrongdoing on its part. In *Wunderlich v. State of California ex rel. Department of Public Works*, a contractor sued the State for breach of implied warranty when ground conditions available at the project site were other than represented in the test data provided to bidders upon inquiry. (65 Cal.2d at pp.779-781.) The Court reversed the judgment previously entered against the State by distinguishing between affirmative representations intended to mislead and those honestly made:

> If the agency makes a "*positive* and *material* representation as to a condition presumably within the knowledge of the government, and upon which . . . the plaintiffs had a right to rely"[,] the agency is deemed to have warranted such facts despite a general provision requiring an on site inspection by the contractor. [Citation] *But if statements honestly made may be considered as suggestive only, expenses caused by unforeseen conditions will be placed on the contractor . . . .*

(*Wunderlich, supra*, 65 Cal.2d at p. 783, emphasis added.)

Thus, as in *Souza*, the Court in *Wunderlich* looked to whether the public entity affirmatively misrepresented information to the contractor. But in *Wunderlich* there was no evidence that the public entity made any affirmative misrepresentation that would justify the contractor's alleged reliance. (*Id.* at p. 784 ["There is no positive representation as to the material content of the Wilder pit. The state did little more than report the results of its testing. 'The borings were merely indications, . . . from which deductions might be drawn as to actual conditions.'"], internal italics omitted; cf. *E. H. Morrill Co. v. State of California* (1967) 65 Cal.2d 787,

791-792 [reiterating the general rule expressed in *Souza*, and holding that a contractor on a public works project could state a claim for breach of implied warranty because information provided by the public entity, and made part of the plans and specifications, constituted a "positive and material representation as to a condition presumably within the knowledge of the government"].) Absent such a representation, this Court found that the State, at most, committed "merely an error of professional judgment," which was *not* actionable, particularly given that the contractor had been invited to investigate the worksite himself. (65 Cal.2d at p. 785 ["under these circumstances, the State is not chargeable for claimant's loss"].)

Several years after *Wunderlich*, this Court returned to the question of what a public contractor must prove in order to maintain a contract action for breach of implied warranty. In *Warner*, a contractor asserted causes of action against the City of Los Angeles for breach of the implied warranty of correctness of plans and specifications and fraudulent concealment based upon the city's alleged misrepresentations and nondisclosures of subsurface soil conditions that the contractor encountered at the project site. (2 Cal.3d at pp. 289-290.) After enumerating three instances in which a cause of action for nondisclosure of material facts may arise,[4] this Court held that liability was appropriate, in part, because the city both affirmatively misrepresented and intentionally failed to disclose information pertaining to inaccuracies in test logs prepared by the city and provided as part of a bid package to the contractor. (*Id.* at pp. 291-292, 294-295 ["The

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[4] Those three instances include: "(1) the defendant makes representations but does not disclose facts which materially qualify the facts disclosed, or which render his disclosure likely to mislead; (2) the facts are known or accessible only to defendant, and defendant knows they are not known to or reasonably discoverable by the plaintiff; or (3) the defendant actively conceals discovery from the plaintiff." (*Warner, supra*, 2 Cal.3d at p. 295, footnotes omitted.)

nondisclosure of the cave-ins and special drilling techniques used in drilling the test holes transformed the logs into misleading half-truths[; t]he facts concealed were exclusively available to defendant[; and] plaintiff presented evidence of intentional concealment by the city."].) Thus, this Court in *Warner* reiterated the general principle that a claim for breach of implied warranty turns upon a contractor's ability to establish either an affirmative misrepresentation or intentional concealment by the public entity.

Relying on this Court's pronouncements in the above cases, numerous courts of appeal have likewise determined liability for breach of implied warranty based on the existence of a positive misrepresentation or fraudulent/intentional concealment by the contracting public agency. In *Wiechmann Engineers v. State of California ex rel. Dept. of Public Works* (1973) 31 Cal.App.3d 741, the Third District Court of Appeal affirmed a trial court's entry of judgment for the State on a contractor's breach of contract action alleging fraudulent concealment of subsoil conditions. The court held that there was no evidence of a "*deliberate or calculated* attempt by the state to create false or misleading information as to subsurface conditions." (*Id.* at p. 751, emphasis added.) Rejecting the contractor's contention that the State had an affirmative duty to disclose information that would have been "of interest" to bidders, and that it failed to do so, the court concluded that an onsite inspection (which the contractor conducted) would have apprised any bidder of the "reasonable probability" that conditions other than those that appeared on the surface of the project site might be found. (*Id.* at pp. 748-749.)

The *Wiechmann* court's reasoning is compelling in this case where the contractor not only had open access to the project site during bidding, but where it also knew when entering the contract that it would be rectifying defective work conducted by a prior contractor, thus suggesting a "reasonable probability" that conditions may have existed that were not

patently apparent from an onsite inspection. The *Wiechmann* court reasoned that a contrary rule attaching liability without any proof of wrongdoing would unjustifiably transform the state into an insurer for the contractor's own negligence:

> A public entity is not liable for an imprudent or careless investigation on the part of a contractor. . . The State of California is not the guardian of every contractor who seeks to perform services for the public and at public expense. Such a concept would be grossly unfair to the prudent and careful contractor who is frequently underbid by a careless competitor. A contractor who submits a bid for public work which proves unprofitable because of his negligence in failing to ascertain all the facts concerning it from sources readily available, cannot thereafter throw the burden of his negligence upon the shoulders of the state by asserting that the latter was guilty of fraudulent concealment in not furnishing him with information which he made no effort to secure for himself. *This is particularly true when the careless contractor is possessed of the kind of knowledge which would concededly prompt a prudent bidder to make further inquiry.*

(*Id.* at p. 753, emphasis added.)

Other appellate decisions like *Jasper*, *Welch,* and, most recently, *Thompson Pacific Construction*, all require that a contractor prove either an affirmative misrepresentation or intentional concealment in order to recover on a claim for breach of implied warranty based on nondisclosure. Thus, the First, Third, and Sixth appellate districts all articulated a standard of liability premised upon a showing that the public agency either affirmatively misrepresented or intentionally concealed information material to the contractor's bid. (See *Jasper, supra*, 91 Cal.App.3d at pp.

7-13; *Welch, supra,* 139 Cal.App.3d at pp. 550, 555-559; *Thompson, supra,* 155 Cal.App.4th at pp. 551-553.)[5]

Indeed, in *Jasper*, the First District Court of Appeal considered the propriety of an implied warranty jury instruction that failed to require evidence of misrepresentation or intentional concealment. (91 Cal.App.3d at pp. 7-11.) Relying on *Souza*, the *Jasper* court concluded that the instruction was erroneous because "[s]ubsequent cases make it clear that there must be an affirmative misrepresentation or concealment of material facts in the plans and specifications in order for the contractor to recover." (*Id.* at p.10 [citing *Wunderlich, supra*, 65 Cal.2d at p. 786 and *Wiechmann, supra*, 31 Cal.App.3d at p. 751].) Conditioning its holding on two key factual determinations—whether the undisclosed information was reasonably discoverable by the contractor, and whether the nondisclosure was material—the court in *Jasper* correctly held that "there can be no liability of a public entity for extra work caused by plans and specifications that are merely 'incomplete.' Furthermore, recovery on this theory cannot be maintained upon a showing of a 'defect' unless that defect consists of *intentional concealment or positive assertions of material facts which prove to be false or misleading.*" (*Id.* at p.11, emphasis added.)

Similarly, in *Thompson*, the Sixth District Court of Appeal considered whether the trial court erred by instructing the jury that an affirmative misrepresentation or concealment of material facts in the plans

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[5] The Court of Appeal interpreted Welch as not requiring an affirmative misrepresentation or intentional concealment and found that there was therefore a conflict among the appellate districts. (*Great American, supra,* 163 Cal.App.4th at p. 964.) As explained below, *Welch* can—and should—be read consistently with cases requiring an affirmative misrepresentation or active concealment. In all events, this Court should make clear that this is a necessary requirement of liability for breach of the implied warranty regardless of how prior cases are read.

and specifications was required for a contractor to recover on a breach of implied warranty claim against a public entity. (155 Cal.App.4th at p. 551.) Consistent with *Jasper*, the *Thompson* court held that "[i]n order to recover on such an action, the contractor must prove that the agency affirmatively misrepresented, or actively concealed, material facts which rendered the bid documents misleading, and that the contractor reasonably relied on such misrepresentations in preparing its bid." (*Ibid.*)

Although the court of appeal in *Welch* reached a different conclusion based on the facts of that case, a close reading of the decision reveals that the *Welch* court was not articulating the type of broad, strict standard of liability adopted by the Court of Appeal in this case. Rather, *Welch* confined its holding to the specific situation where omissions intentionally made by a public entity render misleading the truth of information the public entity had otherwise disclosed. (139 Cal.App.3d at pp. 546, 555, 557-558 ["The undisclosed information doubtless would have qualified or cast doubt upon any false impression of favorable tide conditions given . . . in the general note. The failure to disclose such information compounded the effect of misleading half-truths . . . ."].) Not surprisingly, the *Welch* court held that under such circumstances a public entity can be liable, which is consistent with general tort law that fraud is actionable when a person who voluntarily undertakes a duty to speak on a topic fails to tell the whole truth. (See *Cicone v. URS Corp.* (1986) 183 Cal.App.3d 194, 201 [holding that "where one does speak he must speak the whole truth to the end that he does not conceal any facts which materially qualify those stated. One who is asked for or volunteers information must be truthful, and the telling of a half-truth calculated to deceive is fraud."], internal citation omitted.) Thus *Welch* is entirely consistent with *Jasper* and the other cases discussed above and, as explained in Section II, the Court of Appeal

misread *Welch* when concluding that a conflict exists among appellate courts on this issue.

In light of this long line of authority restricting liability for breach of implied warranty to instances where the public agency either affirmatively misrepresented or actively concealed material information, the standard of liability articulated by the Court of Appeal extends far beyond the scope of liability sanctioned by existing precedent. Indeed, the Court of Appeal's decision essentially subjects public entities to strict liability whenever a contractor can point to some fact or piece of information in a public agency's vast project file that the contractor can claim was not disclosed. Absent a requirement of active concealment or affirmative misrepresentation, public agencies will become highly exposed to after-the-fact claims for breach of implied warranty based on their unique public status. The records, plans, specifications, and other related information upon which any public construction project is based are ordinarily public records. (See generally Gov. Code, §§ 6250-6270 [California Public Records Act].) Thus, public works contractors can obtain information from public entities in search of some shred of information that was not summarized or otherwise disclosed during the bid process, and maintain that the nondisclosure supports a claim for breach of the implied warranty in an effort to transfer liability for their own cost overruns to the public entity. Allowing such a transfer of liability to public entities, or requiring public entities to incur the subsequent litigation costs of trial absent something more, is contrary to existing precedent and creates unsound public policy.

This case is a good example of why the law should require more than mere nondisclosure. Hayward, like the contractors in *Souza, Wunderlich, Wiechmann,* and *Welch*, was not only given open access to the project site, but also the punch list of defective items the School District

provided warned that it should not be read to constitute a final punch list. (1 HA 108:18, 0229-0265.) Moreover, the School District disclosed all information it deemed relevant to the Project's completion. Thus, under the rationales of the cases discussed above, the School District should not be held liable for Hayward's asserted cost overruns where Hayward admitted that it had no factual basis for concluding that the School District intentionally withheld project-related information, or that the School District made any positive misrepresentations. (See 4 HA 1075-1078; *Great American, supra,* 163 Cal.App.4th at p.964 [noting the trial court's finding that "Hayward admitted in deposition that it neither possesse[d] nor [was] aware of any evidence of such affirmative misrepresentation or intentional concealment."].)

B. Analogous Tort Principles Demonstrate that Proof of Intentional Misrepresentation or Concealment Should be Required In Breach of Implied Warranty Cases

The Court of Appeal's decision is also not in keeping with fundamental tort principles. Fraudulent concealment, as its label suggests, requires more than mere silence. To establish a claim for fraudulent concealment, a party must prove (i) the concealment or omission of a material fact, (ii) defendant's duty to disclose that fact, (iii) intentional concealment or suppression, (iv) intent to defraud, (v) justifiable reliance, and (vi) resulting damage. (*Linear Technology Corp. v. Applied Materials, Inc.* (2007) 152 Cal.App.4th 115, 131; *Robinson Helicopter Co., Inc. v. Dana Corp.* (2004) 34 Cal.4th 979, 990 [defining elements of fraud generally].) However, in the absence of such intentional conduct, a party without a fiduciary duty of disclosure is not liable for its failure to speak. (See *Fink v. Weisman* (1933) 129 Cal.App. 305, 318 ["'In the absence of confidential relations, mere silence, without fraudulent acts or omission connected therewith, would not be unconscionable.'"].) As this Court

recognized in *Robinson Helicopter*, "[i]n pursuing a valid fraud action, a plaintiff advances the public interest in punishing *intentional misrepresentations* and deterring such misrepresentations in the future." (34 Cal.4th at p. 992, emphasis added.)

There are no sound reasons for creating a different standard for fraudulent concealment in a breach of warranty case against a public entity. The policy goals of deterrence and protection of the public interest warrant application of an intent element in breach of implied warranty cases based on nondisclosure as well. Indeed, many of this Court's early cases involving contract actions for breach of implied warranty were premised on claims of fraudulent concealment. (See, e.g., *Warner, supra*, 2 Cal.3d at pp. 293-294; *E. H. Morrill, supra*, 65 Cal.2d at pp. 790-792; *Souza, supra*, 57 Cal.2d at pp. 510-511; see also *Wiechmann, supra*, 31 Cal.App.3d at p. 733.) Insofar as these cases consistently applied standards of liability relying on the presence of affirmative concealment/omission, or omission coupled with intentional misrepresentations, they affirmed the general principle that silence, without more, is not actionable. (See *Wiechmann, supra*, 31 Cal.App.3d at p. 751 ["Courts uniformly distinguish between the misleading half-truth, or partial disclosure, and the case in which [the] defendant says nothing at all. *The general rule is that silence alone is not actionable*."], citing *Scafidi v. Western Loan & Bldg. Co.* (1946) 72 Cal.App.2d 550, 563, emphasis added.) So too, in cases such as this, where the public agency has no fiduciary obligations to the contractor, where it has disclosed all project-related information it considered relevant and material at the time of bidding, and where the contractor admits to having no proof of affirmative misrepresentation or concealment by the public agency, the agency's silence alone should not be penalized.

By ignoring these fundamental tort concepts, the Court of Appeal effectively adopted a rule of strict liability for public entities in breach of

implied warranty cases. But there is no legal basis or justification for such a rule. Strict liability is a narrow concept limited to abnormally dangerous activities so that those who are harmed as a result of the activities are compensated, although the utmost care was taken to prevent the harm. (Rest.2d Torts, §§ 519, 520; see, e.g., *Garcia v. Estate of Norton* (1986) 183 Cal.App.3d 413, 418-420 [use of a blowtorch to cut through a waste oil tank]; *Smith v. Lockheed Propulsion Co.* (1967) 247 Cal.App.2d 774, 785-787 [testing with an unusually large rocket motor]; *Luthringer v. Moore* (1948) 31 Cal.2d 489, 496-500 [fumigating with a deadly poison]. But see *Goodwin v. Reilley* (1985) 176 Cal.App.3d 86, 90-92 [concluding that "the act of driving a motor vehicle under the influence of alcohol, although unquestionably dangerous and hazardous-in-fact, does not come within the rubric of an ultrahazardous or abnormally dangerous activity for purposes of tort liability, and [] to hold defendant strictly liable . . . would not, in any event, extend his liability beyond that imposed for negligence"].) There is no reason to extend a like-standard of strict liability to the circumstances presently before the Court, when to do so would absolve contractors of any responsibility to conduct diligent inspections of premises and make necessary inquiries regarding their conditions—responsibilities that are highly warranted in light of the construction expertise that contractors are hired to provide—and then reward the contractors for cost overruns caused by their failures.

Unlike in strict liability cases, where any burden on the defendant from imposition of such a high standard of liability is outweighed by the benefits to the public, in contract cases such as this, where there is no proof of any wrongdoing by the public agency and it is expected that a contractor will take reasonable steps to apprise itself of whatever information it deems necessary to make an appropriate bid, the social value of requiring some showing of affirmative wrongdoing by a public agency militates against

applying a strict liability standard to contract claims for breach of implied warranty based on nondisclosure. The law should encourage, not discourage through strict liability, the building of schools, libraries, hospitals, roadways, and other such constructs that benefit the public.

II. The Court of Appeal's Decision Relies Erroneously On *Welch* and Applies an Unprecedented and Unwarranted Standard for Determining Liability for Breach of Implied Warranty

Despite acknowledging existing California precedent requiring proof of an affirmative misrepresentation or active concealment in order to maintain a breach of implied warranty claim (see, e.g., *Thompson, supra*, 155 Cal.App.4th at p. 551; *Jasper, supra*, 91 Cal.App.3d at p.10), the Court of Appeal concluded that *Welch v. State of California* provided a different and better standard for determining liability in a nondisclosure case. (*Great American, supra*, 163 Cal.App.4th at p. 965.) However, the facts of *Welch* make clear that the decision is not inconsistent with the rule of law applied in *Jasper*, *Thompson*, or the other cases discussed above.

In *Welch*, the State of California contracted to build a pier and, in addition to providing the contractor inaccurate tide data, failed to disclose information regarding a similar project at an adjacent pier approximately six years earlier. In concluding that the contractor could maintain a breach of implied warranty claim absent proof of an affirmative, fraudulent intent to conceal, the *Welch* court based its holding on the fact that the defendant intentionally withheld information that "cast doubt" on the truth of the information the state *did* disclose. (139 Cal.App.3d at pp. 555, 557-558 ["The undisclosed information doubtless would have qualified or cast doubt upon any false impression of the favorable tide conditions given by the tide data in the general note."].) Indeed, the court expressly stated that the State's nondisclosure "*in combination with* [its] affirmative and misleading representation" could serve as the basis for a breach of implied warranty

claim. (*Id.* at p. 550, emphasis added; *see id.* at p. 556 [a cause of action for nondisclosure may arise "when [the omission] is combined with statements of facts which are likely to mislead in the absence of such further disclosure."], internal citation omitted.) Thus, *Welch* is not inconsistent with other cases identified by the Court of Appeal requiring proof of some affirmative misrepresentation or intent to conceal in order to maintain an action for breach of implied warranty based on nondisclosure.

The limited scope of the *Welch* holding is confirmed by the fact that the court expressly declined to rule on the broad issue of liability for which the Court of Appeal here cited *Welch.* Specifically, the plaintiff contractor in *Welch* argued that the Government Code "imposes a *broader obligation* on the State to disclose 'complete' information irrespective of whether [it] has affirmatively made misleading representations or partial disclosures." (*Id.* at p. 559, emphasis added.)[6] The court determined that because reversal was required on "the more limited ground" that a public entity can be held liable for breach of implied warranty when it intentionally withholds information that would cast doubt on the truth of information otherwise disclosed, it did not need to reach the question of whether a broader rule of liability such as that imposed by the Court of Appeal in *Great American* was warranted or required. (*Id.* at pp. 559-560.) Thus, contrary to the Court of Appeal's assertion, no conflict among appellate courts of this State existed prior to its own decision. (See *Great American, supra*, 163 Cal.App.4th at p. 964.)

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[6] The Government Code provision relied on in *Welch* is now codified in Section 10120 of California's Public Contract Code. (*Welch, supra*, 139 Cal.App.3d at p. 559.) Section 10120 applies to "departments," as defined in Section 10106, and does not apply to school districts. In any event, the issue of this statute's application was not raised below.

III. The Court of Appeal's Decision Creates an Untenable Precedent for Public Entities Throughout California and Constitutes Unsound Public Policy

A. The Decision Undermines the Purpose of California's Competitive Bidding Statutes

As this Court is well aware, public works contracts are the subject of intensive statutory regulation. Among those provisions of the Public Contract Code governing competitive bidding requirements, contracts for work exceeding a specified dollar amount must be awarded to the lowest responsible bidder after competitive bidding. (See, e.g., Pub. Contract Code, § 20111, subds. (a)-(b).) The California legislature expressed its objectives in adopting a consolidated Public Contract Code as follows: "ensur[ing] full compliance with competitive bidding statutes as a means of protecting the public from misuse of public funds;" "provid[ing] all qualified bidders with a fair opportunity to enter the bidding process, thereby stimulating competition in a manner conducive to sound fiscal practices;" and "eliminate[ing] favoritism, fraud, and corruption in the awarding of public contracts." (Pub. Contract Code, § 100, subds. (b)-(d).) Indeed, this Court has acknowledged that the competitive bidding statutes were "enacted for the benefit of property holders and taxpayers, and not for the benefit or enrichment of bidders, and should be so construed and administered as to accomplish such purpose fairly and reasonably with sole reference to the public interest." (*Kajima, supra*, 23 Cal.4th at pp. 316-317.)

Considering the unique constraints placed on public agencies under California's public contracting statutes, a rule of law that imposes liability on public entities whenever material information goes undisclosed—regardless of intent—risks punishing public agencies for innocent omissions of fact it was either unaware at the time of bidding, or which it

did not consider material to a project's bid. (See *id.* at p. 317 [emphasizing that "prudence is warranted whenever courts fashion damages remedies in an area of law governed by an extensive statutory scheme."].) Such a rule also ignores the reality that public owners simply do not have the same freedom to contract as do private owners. (See *Amelco, supra*, 27 Cal.4th at p. 242 [distinguishing cases involving private construction contracts on the basis that public works contracts "lack the freedom of modification present in private party contracts"].) Adopting a rule that will unduly punish the taxpaying public through "faultless" breach of warranty claims, and that will in turn unjustifiably reward contractors, is not in the public interest.

In light of the more than 80 billion[7] dollars in public funds that have been allocated to the completion of public works projects in California, substantially increasing the scope of liability that public entities face when entering into these projects will significantly undermine the purpose for which this money is to be spent. Rather than spending funds to build critical infrastructure, money will be siphoned away from projects to

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[7] In 2006 California voters approved a measure allocating more than 40 billion dollars to public works projects, and a proposal is in place to approve an additional 48 billion dollars by 2010. These statistics are from the *2008 California's Five Year Infrastructure Plan*, as reflected on the California Department of Finance's Web site on November 25, 2008, (<http://www.dof.ca.gov/capital_outlay/reports/documents/Infra-Plan-08-w.pdf>, at pp.1-4). As the Court is aware, California voters approved in the November 2008 election tens of billions of dollars in additional bonds to fund public works projects across the state ranging from construction of schools to development of a high speed rail line. (See Blume and Song, *Voters Pass All 23 L.A. County School Bond Measures*, Los Angeles Times (Nov. 6, 2008) < http://www.latimes.com/news/education/la-me-school6-2008nov06,0,1290117.story> [as of Nov. 26, 2008]; *California Voters Back Bond for High-Speed Train*, Daily Commercial News and Construction Record (Nov. 12, 2008) <http://www.dcnonl.com/article/id31296> [as of Nov. 26, 2008].)

defend against lawsuits where there has been no wrongdoing by the public agency. As is the case here, under the standard adopted by the Court of Appeal, public entities will be unable to bring to an early end breach of implied warranty claims where there is no evidence of active concealment or intentional misrepresentation. As public entities proceed with crucial public works projects, public owners (and taxpayers) need assurance that courts will craft and apply consistent rules of law that uphold the legislative intent behind California's competitive bidding statutes. (See *Kajima, supra*, 23 Cal.4th at pp. 317-318 ["In determining what remedy 'justice requires,' it is incumbent on this court to consider the broad-ranging social consequences of the chosen remedy."].) By reversing the Court of Appeal's decision, and determining that proof of an affirmative misrepresentation or active concealment is a requisite element of a breach of implied warranty claim based on nondisclosure, this Court will be doing exactly that.

B. The Decision Encourages Underbidding and Forces Public Agencies to Act as Insurers for Contractors

In addition to undermining the statutory authority under which public construction contracts are regulated, the Court of Appeal's ruling encourages contractors to underbid projects and also provides a disincentive for contractors to perform the level of due diligence the public expects and deserves. In framing legal standards for public works projects, this Court has been careful to avoid adopting arguments that encourage such conduct. (See *Amelco, supra*, 27 Cal.4th at p. 240 ["allowing contractors to recover in quantum meruit for the actual as opposed to the bid cost of a project would encourage contractors to bid unrealistically low with the hope of prevailing on an abandonment claim based on the numerous changes inherent in any large public works project."].)

In their effort to secure public construction contracts, contractors will have an incentive to bid sufficiently low to guarantee award of the contract, and, upon experiencing cost overruns that they are unwilling to assume, can thereafter scour the large volumes of information public agencies collect and summarize as part of an invitation for bid. The aim of the review of public records would be to find the proverbial needle in the haystack—a piece of information in the public agency's files that the contractor can contend was not adequately summarized or otherwise disclosed—to serve as a hook for a nondisclosure claim even in the absence of an affirmative misrepresentation or active concealment. This would, in effect, make public entities insurers for contractors, which is precisely the result the *Jasper* court deemed unfair and unacceptable. (91 Cal.App.3d at p.10 ["'Of course, the government does not become an insurer merely by providing certain information.'"].) Such a result places too great a financial burden on public entities, as well as the taxpaying public, and is inconsistent with the legislature's reluctance to expand the liability of public agencies.[8] (See *Wunderlich, supra*, 65 Cal.2d at p. 786 ["It is obvious that a governmental agency should not be put in the position of encouraging careless bidding by contractors who might anticipate that should conditions differ from optimistic expectations reflected in the

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[8] See Gov. Code, § 818.8 ("[a] public entity is not liable for an injury caused by misrepresentation by an employee of the public entity, whether or not such misrepresentation be negligent or intentional."].) Notwithstanding that a cause of action may lie in contract, the rule set down by the Court of Appeal in this case would expose public agencies to the same type of liability the legislature sought to curb by precluding misrepresentation actions in tort. By negating a required showing of active concealment or intentional misrepresentation from a breach of implied warranty claim, public works contractors will be able to achieve the same end (i.e., imposing liability on public entities for misrepresentations, *whether negligent or intentional*) by much easier means.

bidding, the government will bear the costs of the bidder's error."].) Where funding approved by California voters for the development of much needed public constructs as schools, libraries, hospitals, and roadways is diverted to cover litigation costs associated with ever-increasing public construction contract disputes, substantially less funding is available for necessary, and taxpayer financed, public works projects.

C. The Decision Unjustly Imputes to Public Agencies A Duty to Determine What Constitutes Material Information

As the Court of Appeal aptly recognized, the undisclosed facts supporting a contractor's breach of implied warranty claim must be "material" to the contractor's bid. (*Great American, supra*, 163 Cal.App.4th at p. 964; see *Warner, supra*, 2 Cal.3d at p. 294; *Wunderlich, supra*, 65 Cal.2d at p. 783; *Thompson, supra*, 155 Cal.App.4th at p. 551; *Welch, supra*, 139 Cal.App.3d at pp. 555-556; *Jasper, supra*, 91 Cal.App.3d at p.10.) Yet application of the rule articulated by the court imputes to public agencies an unprecedented and unjust duty to determine, at the time of bidding, what information a contractor may later deem material. To be sure, in cases such as this, where the public entity provided the contractor all the information it considered relevant and material to the project, and did not actively conceal or affirmatively misrepresent any facts, or otherwise engage in any intentional wrongdoing, the School District would nonetheless be subject to liability if the contractor deemed innocently omitted information material. Expanding the bounds of a public agency's disclosure obligations like this effectively negates *any* obligation on the part of the contractor to diligently, prudently, and completely conduct essential investigations and inquiries that would bear on its bid. What is worse, the Court of Appeal's ruling risks so burdening public entities as to require virtually unending disclosure of information—including information pertaining to entirely different public works projects

than that being bid—if there is a remote possibility that a contractor might deem the information material to the project for bid.

Another important consideration is that public agencies lack the expert knowledge in construction for which the contractor is hired. Indeed, public agencies rely on the contractor's expertise to satisfy both parties that their expectations with respect to project conditions and construction are met. If an omission, regardless of intent, must both materially affect a contractor's bid and be known only to the public agency (see *Warner, supra*, 2 Cal.3d at p. 294), then apart from creating a strict duty to disclose material information, the Court of Appeal's decision imposes the added responsibility on public entities to determine what a given contractor may or may not deem material. Requiring this kind of balancing of unknowable factors obviates any responsibility of the contractor to conduct due diligence, which is not in the public interest. Such an unintended, unfair, and untenable rule affecting the relationships between parties to public works contracts, not to mention the public interest, should not be upheld.

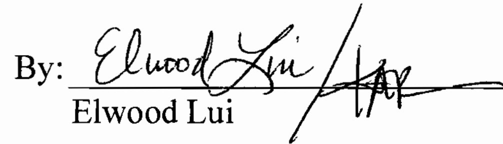
CONCLUSION

In light of the broad policy concerns implicated by the Court of Appeal's decision, and considering the sweeping effect that such an unsupported rule of law would have on the future of public construction throughout California, the School District respectfully requests that this Court reverse the Court of Appeal's ruling, finding instead that, in keeping with existing precedent, a contractor must prove either affirmative misrepresentation or active concealment by a public agency in order to maintain a contract action for breach of implied warranty based on nondisclosure.

Dated: December 1, 2008

Respectfully submitted,

Jones Day

By: 
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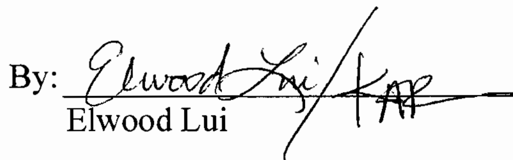
CERTIFICATE OF COMPLIANCE

Counsel of Record hereby certifies, pursuant to Rule 8.520(c)(1) of the California Rules of Court, that the enclosed brief was produced using 13-point type, including footnotes, and contains approximately 7,915 words, which is less than the 14,000 words permitted by this Rule. Counsel relies on the word count of the computer program used to prepare this brief.

Dated: December 1, 2008

Respectfully submitted,

JONES DAY

By: 
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Susan C. Ballard

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