REPORT TO COUNCIL 45
City of Sacramento

915 I Street, Sacramento, CA 95814-2604
www. CityofSacramento.org

CONSENT
June 26, 2007

Honorable Mayor and
Members of the City Council

Title: Authorization to Submit Amicus Curiae Letter in Support of SMUD's Petition for Review of Court of Appeal Decision in *Condon-Johnson & Associates v. SMUD*

Location/Council District: Citywide.

Recommendation: Adopt a Resolution authorizing the City Attorney to submit a letter in support of SMUD's Petition for Review of the Court of Appeal Decision in *Condon-Johnson & Associates v. SMUD*.

Contact: Eileen Teichert, City Attorney, (916) 808-5346; Joe Robinson, Senior Deputy City Attorney, (916) 808-5346.

Presenters: None

Department: City Attorney

Organization No: 0500

Description/Analysis

Issue: The *Condon-Johnson & Associates v. SMUD* case involved a claim against SMUD on a public works construction contract, in which the contractor requested additional payment for costs arising from subsurface conditions. In April 2007, the California Court of Appeal issued a decision in this case prohibiting SMUD from relying on disclaimers in the contract specifications that otherwise would have limited SMUD's liability to the contractor for additional costs. SMUD is filing a Petition for Review with the California Supreme Court to request that the Supreme Court review and overturn this decision. This report recommends that the City Council authorize the City Attorney to file an *amicus curiae* letter with the Supreme Court in support of SMUD's request that the Court grant review of this decision.

Policy Considerations: The Court of Appeal decision has the potential to adversely affect all local public entities in California, including the City, that utilize disclaimers or other risk-shifting clauses in construction contracts. If the California Supreme Court grants SMUD's Petition for Review, this will ensure that the Court of

Appeal decision is reviewed by the State's highest level of judicial authority before a binding legal precedent is established.

Environmental Considerations: Authorizing the filing of a letter in support of SMUD's Petition for Review does not constitute a "project" that requires environmental review under the California Environmental Quality Act.

Rationale for Recommendation: Authorization to file an *amicus curiae* letter is requested in order to inform the California Supreme Court that the City supports SMUD's request that the Court grant judicial review of the lower court decision.

Financial Considerations: Filing an *amicus curiae* letter has no financial impact on the City. If the California Supreme Court grants review and overturns the Court of Appeal decision, this could result in lower construction costs for local public entities by preserving their ability to rely on disclaimers and other risk-shifting provisions with respect to subsurface conditions.

Emerging Small Business Development (ESBD): Not applicable, as this item does not relate to the procurement of goods or services.

Respectfully Submitted by:
EILEEN M. TEICHERT
City Attorney

Recommendation Approved:

for RAY KERRIDGE
City Manager

Table of Contents:

Report Pg 1
Attachments
1 Background Information Pg 3
2 Resolution Pg 5

Attachment 1

Background Information:

Condon-Johnson was the successful bidder for a contract with SMUD to drill foundations approximately 60 to 80 feet deep into the side of a mountain where SMUD operates a powerhouse. At the request of a bidder, SMUD selected and tested two rock samples from a larger core sample that had been taken near - but not at - the specific jobsite.

SMUD published the results of these rock-strength tests (3,600 to 7,300 psi) to bidders, but specifically warned bidders in writing to not assume, based on the two tests, subsurface conditions for the entire mountain. SMUD also disclaimed the accuracy of the tests, and informed bidders that SMUD would not make extra payments based on a contractor's failure to determine existing conditions.

Despite SMUD's warnings, Condon-Johnson bid the project assuming that the two rock-strength tests were representative of the entire mountain. During the drilling, Condon-Johnson's crews encountered rock that was harder (13,000 psi) than the samples, and the contractor requested additional payment for its increased drilling costs. SMUD denied the request and Condon-Johnson sued SMUD.

At trial, the judge ruled that State law (Public Contract Code Section 7104) prohibited SMUD from relying on the disclaimers that Condon-Johnson had accepted as part of the contract, and did not allow SMUD to present these disclaimers to explain to the jury why it refused to pay Condon-Johnson's claim. The jury subsequently awarded damages to Condon-Johnson, and judgment was entered in the contractor's favor in the amount of $1,635,421.79.

SMUD appealed the trial court's decision to exclude all evidence of SMUD's disclaimers and other exculpatory provisions, based on SMUD's contention that the trial court's interpretation of Section 7104 was incorrect. However, in a 2-1 vote, the Third District Court of Appeal upheld the trial court's decision.

Unless it is overturned, this decision will be the first published judicial decision to address Public Contract Code Section 7104, and could adversely affect local public entities in California by preventing the use of disclaimers or other risk-shifting clauses in construction contracts to qualify information regarding subsurface conditions, or to warn the contractor against making certain deductions regarding subsurface conditions. This, in turn, has the potential to drive up the cost of construction contracts by local public entities.

Under California law, local public entities already can be sued by a construction contractor for failing to disclose material facts. For example, if a local public entity possesses information that it does not know to be accurate, but that directly pertains to the construction project site, it should disclose the information to avoid a nondisclosure claim. Yet, under the *Condon-Johnson* decision's interpretation of State law, the entity cannot disclaim or qualify the accuracy of the information. Thus, the local public entity in

this hypothetical can disclose the information and run the risk of increased costs resulting from the Contractor's reliance of the information without regard to the entity's disclaimers or qualifications, or the entity can hold the information back and run the risk of being sued for nondisclosure. Neither alternative is a tenable position for local public entities.

The City Code provides that various Public Contract Code provisions, including Section 7104, do not apply to City construction contracts due to the City's status as a charter city; however, this exemption may not apply in all cases, such as for State-funded contracts. In addition, the City relies on appropriate disclaimers, qualifications and other risk-shifting provisions in the City's construction contracts to protect the City, and City residents, against claims for additional costs on construction contracts. Aside from its questionable interpretation of Section 7104, the Court of Appeal's decision in *Condon-Johnson* could lead to other limitations on the City's ability to rely on disclaimers and risk-shifting provisions in City construction contracts, to the detriment of the City and City residents. The City Attorney is seeking authorization to file a letter in support of SMUD's Petition for Review to the California Supreme Court because we believe that further judicial review of the Court of Appeal's decision would benefit all local public entities that administer construction contracts, including the City.

RESOLUTION NO. 2007-XXXX

Adopted by the Sacramento City Council

June 26, 2007

AUTHORIZATION TO SUBMIT AMICUS CURIAE LETTER IN SUPPORT OF SMUD'S PETITION FOR REVIEW OF COURT OF APPEAL DECISION IN *CONDON-JOHNSON & ASSOCIATES V. SMUD*

BACKGROUND

A. The *Condon-Johnson & Associates v. SMUD* case involved a claim against SMUD on a public works construction contract, in which the contractor requested additional payment for costs arising from subsurface conditions.

B. In April 2007, the California Court of Appeal issued a decision in this case prohibiting SMUD from relying on disclaimers in the contract specifications that otherwise would have limited SMUD's liability to the contractor for additional costs. The Court of Appeal decision has the potential to adversely affect all local public entities in California, including the City, that utilize disclaimers or other risk-shifting clauses in construction contracts.

C. SMUD is filing a Petition for Review with the California Supreme Court to request that the Supreme Court review and overturn this decision.

D. The City Attorney has requested authorization to file an *amicus curiae* letter with the California Supreme Court in support of SMUD's request that the Court grant review of this decision.

BASED ON THE FACTS SET FORTH IN THE BACKGROUND, THE CITY COUNCIL RESOLVES AS FOLLOWS:

Section 1. The City Attorney is authorized to file an *amicus curiae* letter with the California Supreme Court, on behalf of the City, in support of SMUD's Petition for Review of the Court of Appeal decision in *Condon-Johnson & Associates v. SMUD*.