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AMBIGUITY IN THE LAW OF GOVERNMENT CONSTRUCTION CONTRACTS

California spends in excess of \$400,000,000 a year for highway construction contracts. In the fiscal year 1964-65 this expenditure involved 563 major construction contracts.¹ On a smaller scale, the counties and cities similarly expend large amounts each year to insure that travel facilities measure up to the demands of an ever increasing population. The accumulation of capital investment in this area serves to magnify the necessity for clarity and precision in defining the limits of responsibility of the state as well as of the bidding contractor. Recent litigation has introduced some conflict concerning the interpretation of standard terms and conditions specified in these contracts. The lack of uniformity presented by these recent decisions must be resolved if the state and bidding contractors are to be able to formulate their contracts with assurance. This comment will examine the most recent case law and discuss its practical effect upon future negotiations.

THE PROBLEM

The public agencies representing the State of California generally conduct tests and obtain information as to various construction materials available and conditions to be encountered in the construction of a particular road. These agencies have universally allowed prospective bidders to utilize this information in making their bids, subject to limitations set forth in the construction contract. Providing this information without warranty permits a number of contractors to submit bids who, because of their relatively small size, would be otherwise unable to do so. Thus providing the information has a salutary effect of making the bidding more competitive, resulting of course in reduced costs to the state in the bids submitted. In short, the existing system has proved mutually beneficial to both interests.

Typically, construction contracts incorporate an exculpatory provision which imposes upon bidders the responsibility for site examination, warns that subsurface data in the state's hands is available to bidders only for their convenience, and declares that the state assumes no responsibility for the accuracy of the data it provides.² Various interpretations have been made in recent years regarding the effect to be given these disclaimer provisions. Some

¹ California Highways and Public Works, Annual Report Issue, Nov.-Dec. 1965.

² *A. Teichert & Son, Inc. v. State*, 238 Cal. App. 2d 736, 754, 48 Cal. Rptr. 225, 237 (1965).

interpretations serve a valuable function as a logical extension of California's abrogation of the rule of governmental immunity. Conversely, some of the later cases in this area might well have gone too far when analyzed with respect to current practices. Disseminating the various imminent changes which could be necessitated should lend authoritative guidance to those concerned as to the consequences which can be expected from failure to recognize the heretofore established judicial panoply of contractual provisions.

THE CASE LAW

A well established rule in California is that when the state contracts with an individual, it is liable for a breach of its agreement in like manner as an individual, and the doctrine of governmental immunity does not apply.³ But as to the limitations which the state may impose upon such liability by express disclaimer in the contract, the cases demonstrate a marked divergence of opinion which in the final analysis is best described as arbitrary interpretation on the part of individual courts.

Probably the most common distinction drawn to determine the weight attached to a disclaimer of responsibility is between inaccurate project information furnished as a "basis for bids" and that furnished as mere "geological data."⁴ Some cases hold that a contractor who is misled by incorrect plans and specifications issued by the public authorities as the *basis for bids*, and who submits a bid which is lower than he otherwise would have made, may recover in a contract action for extra work or expenses necessitated by the conditions being other than as represented.⁵ Contrary to these cases in such authority as *Rocell Construction Co. v. State*⁶ holding that if an agency makes *geological data* available under a disclaimer of responsibility, the contractor bears any loss occasioned by unexpected conditions. Of course, such recognition of the state's right to limit its responsibility is subject to the requirement that the state act in good faith and avoid either intentional misrepresentation or withholding of material information.⁷

³ *California Highway Comm'n v. Riley*, 192 Cal. 97, 107, 218 Pac. 579, 584 (1923); *Union Trust Co. v. State*, 154 Cal. 716, 728, 99 Pac. 183, 188 (1908); *Chapman v. State*, 104 Cal. 690, 38 Pac. 457 (1894); *Carmichael v. Riley*, 56 Cal. App. 409, 205 Pac. 478 (1922).

⁴ *E.g.*, *Souza & McCue Constr. Co. v. Superior Court*, 57 Cal. 2d 508, 510, 370 P.2d 338 (1962); *Gogo v. Flood Control Dist.*, 45 Cal. App. 2d 334, 114 P.2d 65 (1941).

⁵ *E.g.*, *United States v. Spearen*, 248 U.S. 132, 136 (1918); *Christie v. United States*, 237 U.S. 234, 239-42 (1914).

⁶ *Rocell Constr. Co. v. State*, 208 Misc. 364, 141 N.Y.S.2d 463 (1955).

⁷ *Id.* at 370, 141 N.Y.S.2d at 469.

Another court, in *United States v. Johnson*,⁸ asserts a distinction where the contractor is specifically required to use a certain source of materials on the basis of tests taken and referred to by the state.⁹ This court reasoned that, notwithstanding the disclaimer clause, the representation in a highway construction contract that rock suitable for crushing is available at a certain point, and that *only* such rock is to be used is sufficient to establish a warranty upon which the contractor might rely.¹⁰

Other authorities, e.g., *Flippen Materials Co. v. United States*,¹¹ emphasize the incumbency upon the bidder to be aware of the information provided in full detail. Such contractor cannot choose to rely on some portion of the information supplied by the state, while at the same time failing to look at other materials which qualify or explain the particular segment upon which the contractor intends to rely.¹² In *Montrose Contracting Co. v. County of Westchester*,¹³ the court allowed recovery by the contractor, but stated that if inspection would have revealed the falsity of the county's representations, then the contractor would not have been able to rely on the incorrect information, since the contract placed upon the contractor a duty to study all subsurface information at his own risk. Similarly in *City of Reading v. Rae*,¹⁴ the jury found fraudulent misrepresentation, but the court noted as dictum that it must be determined, if fraud had not been found, whether the subsurface conditions could have been discovered by the exercise of reasonable diligence by the contractor.

Cases such as *Flippen*, *Montrose*, and *Reading* all have in common the basic element of ignoring the distinction between "basis of the bid" and "geological data"; rather these cases base their rationale upon a full integration of all the terms of the contract. In the light of this full integration, if it is decided that the contractor has abided by all the terms of the contract he will be allowed to enforce the terms under which he seeks recovery. Thus, the state's furnishing of information does not relieve the contractor of his duty to investigate and assume responsibility for site examination, if so provided in the contract.

Another line of cases, e.g., *Day v. United States*¹⁵ and *Phoenix Bridge Co. v. United States*,¹⁶ takes the position that where one

⁸ 153 F.2d 846 (9th Cir. 1946).

⁹ *Ibid.*

¹⁰ *Ibid.*

¹¹ 312 F.2d 408 (Ct. Cl. 1963).

¹² *Id.* at 413.

¹³ 80 F.2d 841 (2d Cir. 1936).

¹⁴ 106 F.2d 458 (3d Cir. 1939).

¹⁵ 245 U.S. 159 (1918).

¹⁶ 211 U.S. 188 (1908).

agrees to perform for a fixed sum a thing possible to be performed, he will not be excused or become entitled to additional compensation because unforeseen difficulties are encountered. This latter view, espoused in some of the older cases, rests on the rationale that whenever someone contracts to perform, he can never be sure that he will be able to do so. Thus, the very essence of contract law is that two parties take the risk which the contract imposes upon them, *i.e.*, the risk that they can fully perform. In view of the modern trend in construction contracts to allow the courts greater freedom in interpreting the subjective "intent" of the parties by their language, the absoluteness of such cases as *Day* and *Phoenix Bridge* in determining the scope of the undertaking by the literal meaning of the words alone has become palpably obsolete in the majority of our courts.

However, spanning a half century and looking at two recent cases in the California District Court of Appeal, it becomes obvious what the result has been of the "enlightened view" of subjective interpretation by the courts. In an area which by its very nature demands clarity and precision, we find confusion and conflict. The two cases presenting this conflict are *A. Teichert & Son, Inc. v. State*¹⁷ and *Wunderlich v. State*.¹⁸ Note that these two decisions only highlight the problem as it has already clearly existed over the last half century as evidenced by the divergence in the cases already discussed.

The facts of *Teichert*¹⁹ are directly analogous to those in *Wunderlich*.²⁰ The defendant in both instances is the State of California and the disclaimer provisions in the contracts are essentially the same.²¹ Both actions were brought seeking damages for breach of

¹⁷ 238 Cal. App. 2d 736, 48 Cal. Rptr. 225 (1965).

¹⁸ 241 A.C.A. 58, 50 Cal. Rptr. 151 (1966). Note that this case will not be found in the bound volume of 241 Cal. App. 2d, since it has been reversed by *Wunderlich v. State*, 65 A.C. 830, 423 P.2d 545, 56 Cal. Rptr. 473 (1967).

¹⁹ In *Teichert*, the plaintiff, A. Teichert & Son, Inc., a highway construction contractor, had been furnished a materials report by the state describing moisture conditions at certain points in the project area. Excessive moisture encountered by the plaintiff, contra the state's report, resulted in excess costs and delay in installing drainage facilities and in meeting soil compaction requirements.

²⁰ In *Wunderlich*, the plaintiff, a highway construction contractor, relied on samples taken by the state as to the consistency of particular material to be used from one of two sites designated in the contract. The breach of warranty occurred when the waste sand produced by plaintiff in their processing the native material was greater than anticipated when they submitted their bid. The state was said to have warranted the quantity of waste sand that plaintiffs would handle in producing their products from the specified location.

²¹ In *Teichert* the court refers to section 2(a) of the STANDARD SPECIFICATIONS OF THE STATE DEPARTMENT OF PUBLIC WORKS, DIVISION OF HIGHWAYS, which was incorporated into the contract and imposes upon bidders the responsibility for site examination, warns that subsurface data in the state's hands is made available to

warranty based on the state's disclosure of subsurface conditions as ascertained by state employees. Similarly, in both instances the state set up the defense that express exculpatory terms of the contract prevented any warranty from coming into existence.

In *Teichert*, the court sustains the state's defense by concluding that the state's soil data was not furnished to bidders as a *basis* for computing bids. This interpretation by the court, though of itself sufficient to support their verdict, was supplemented when the court specifically stated that the exculpatory provisions of section 2(a) of the Standard Specifications²² clearly demonstrate that the state did not intend to make any warranty as to the information supplied. This latter reasoning has no less support than Mr. Justice Holmes who articulately stated in 1917²³ that when the scope of an undertaking is fixed by contractual provision, it is merely another way of saying that the contractor takes the risk of the obstacles to that extent. Thus, by the view of the *Teichert* case under either of its two distinct rationales, the state will not be liable for information provided to bidding contractors if the appropriate exculpatory provisions are placed in the contract.

In *Wunderlich*, the court chose to ignore the interpretation set out by its sister court in *Teichert*, awarding damages to the plaintiff contractor for breach of warranty. The *Wunderlich* court expresses the opinion that it would not be reasonable to hold that the state, by resorting to provisions of an exculpatory nature in the standard specifications, could escape responsibility for the accuracy of information upon which bidders place reliance in formulating their bids. The court concludes that in such circumstances it would be unfair to relieve the state of liability by contractual provisions requiring the bidder to investigate a source of materials which is designated by the state as being satisfactory in nature. The court refers to

bidders only for their convenience, and declares that the state assumes the responsibility for the accuracy of such data. Similarly Section 5(a) of the Standard Specifications declares that the State Highway Engineer's decisions as to acceptability of performance and as to compensation shall be final. 238 Cal. App. 2d at 754, 48 Cal. Rptr. at 237.

In *Wunderlich*, judicial notice was directed to specified provisions in the contract stating:

- (1) That the use of the site inspected by the state was optional with the bidder.
 - (2) That if the bidder desired to use such site, he had the obligation to satisfy himself as to the quantity of material.
 - (3) That bidders may inspect all test reports made by the state, but subject to the bidders' own interpretation of such information.
 - (4) That bidders are required to bid on the basis of their own investigation.
- 50 Cal. Rptr. at 161.

²² See explanation in note 21 *supra*.

²³ *Day v. United States*, 245 U.S. 159, 161 (1918).

*Hollerbach v. United States*²⁴ as its authority; though not expressly stated in the opinion, presumably the court reasoned that the information provided Wunderlich was used as a "basis for the bid," since no deliberate misrepresentation or concealment appeared in the facts. Since the discussion in *Wunderlich* as to the express disclaimer clauses in the contract is limited to one paragraph without distinguishing any authority outside *Hollerbach*, the court apparently chose to ignore the limiting clauses of the contract on the grounds that the information provided was the "basis for the bid."

Regardless of what theory the court used in deciding the *Wunderlich* case, it is clear, considering the express language of the contracts in *Teichert* and *Wunderlich*, that a lack of uniformity of decision exists between the two courts. Further, compounding this inconsistency, is *Teichert's* approval of *T. Kelly & Son, Inc. v. Los Angeles*²⁵ juxtaposed with *Wunderlich's* failure to distinguish either the *Kelly* or the *Teichert* decisions.²⁶

Upon appeal to the California Supreme Court *Wunderlich* was reversed²⁷ with Justice Peek expressing the basis of the court's decision on two postulates. First, in interpreting the language of the state's contract, the court acknowledges the state's contention that it was not chargeable for the loss caused to the contractor by the material falling short of expectation. Since the contractor relied on language which merely said that "samples indicated" the availability of the site and further refused to make his own investigation as suggested by the state, he could not be allowed to benefit by his own negligence.

Second, the court reasons that regardless of what the statements represented to bidders, the state explicitly at the outset of the same paragraph in which the representation is found, disclaimed all responsibility for the quantity of acceptable material. In citing authority for their position the court turned to *MacArthur Bros. Co. v. United States*,²⁸ and in particular the rationale in that case which pointed out that to hold the government liable for their approximate specifications would, in effect, cast upon it responsibility for all the

²⁴ 233 U.S. 165 (1913). The Government was mistaken in its specifications as to the backing behind a dam. The Government represented that the dam was backed by broken stone, sawdust, and sediment; but instead the dam was backed by soft slushy sediment. In spite of exculpatory provisions to the contrary, the representations were construed as binding upon the Government and upon it rather than the contractor, fell the risk of the loss.

²⁵ 6 Cal. App. 2d 539, 45 P.2d 223 (1935).

²⁶ *Wunderlich v. State*, 241 A.C.A. 58, 50 Cal. Rptr. 151 (1966).

²⁷ *Wunderlich v. State*, 65 A.C. 830, 423 P.2d 545, 56 Cal. Rptr. 473 (1967).

²⁸ 258 U.S. 6 (1922).

conditions which a contractor might encounter and make the estimated cost of its projects an unknown quantity.²⁹

Though the supreme court decision of *Wunderlich* makes no reference to the *Teichert* case, the approach taken by the court in the former is remarkably similar to that in the latter lower court's ruling and hopefully should lend considerable authority to the line of cases which have chosen to deal with the contractual disclaimers of the government as an express bar to action by the bidding contractor.

The best solution to the question presented by this confused line of authority on how much weight is to be attached to express disclaimer clauses in government construction contracts is best discoverable in comparing the practical results to be expected in following either one of the two alternative positions established by the cases. One draws the inescapable conclusion that the state must be allowed to insert exculpatory provisions in their construction contracts with the assurance that the courts will take judicial cognizance of such provision; and that perhaps the problem has finally been set to rest by the overturning of the lower court *Wunderlich* decision.

State highway construction contracts must be awarded through the system of competitive bidding if in excess of \$5,000.00.³⁰ Competitive bidding has historically been favored and protected by the courts and is intended to promote competition so that all contracts can be let at the lowest cost to the public. In order that the bidding process be effective, it is essential that the state as well as the bidder be able to look to the terms of the contract for the determination of contractual duties and responsibilities. Following the view taken in *Hollerbach* and its progeny³¹ the havoc to competitive bidding is readily discernible.

A contractor who is aware of the advantage to be gained through advantageous interpretation of the language of the contract would be able to exercise unfair advantage over the other bidders. Such a contractor would merely submit a low bid disregarding any risk involved in the project, gambling that he would be able to recover any loss through litigation should any problem arise from unexpected occurrences. Conversely, following the rule of strict interpretation of the contractual provisions³² or that group of cases following the

²⁹ *Id.* at 13.

³⁰ CAL. GOV. CODE § 14256: "If the estimated total cost of any construction project or work carried out under this section exceeds five thousand dollars (\$5,000.00), the district or agency shall solicit bids in writing and shall award the work to the lowest responsible bidder or reject all bids . . ."

³¹ *E.g.*, *Wunderlich v. State*, 241 A.C.A. 58, 50 Cal. Rptr. 151 (1966).

³² *Day v. United States*, 245 U.S. 159 (1918); *Phoenix Bridge Co. v. United States*, 211 U.S. 188 (1908).

“geological data” line of thinking,³³ each bidder would be required carefully to include in his bid the element of risk if so imposed upon him by the terms of the contract. If a contractor chooses to forego the charge in his estimate, then he assumes the risk that his decision contains, while at the same time gaining a commensurate advantage over the other contractors whose bids reflect the cost of the calculated risk.

Looking at another practical aspect of the problem, what would be the result in an obverse to the usual situation? Such an example would arise where the bidder over-estimates the cost of a particular project and yet gets the job. There is no authority to be found and probably never will be to the effect that a bidder must offer the state a refund on his bid price if he inadvertently over-estimates the difficulty of the job and is still fortunate enough to obtain the contract. In other words, the contractor can sometimes gain the benefit, just as well as incur the detriment, from the occurrence of unexpected contingencies. If the terms of the contract provide that the contractor must bear the risk of investigation, it is only equitable that he be required to do so, since under that same contract he will be able to profit by the advantages which might just as likely happen to arise.

Furthermore, assuming the state cannot disclaim responsibility for any information it gathers and makes available to the bidders, a rather strange paradox arises. It has been held that the federal government has a *duty*, if it has made borings or is in possession of pertinent information, to fully disclose and furnish facts discovered.³⁴ Thus, by analogy, the state may be obligated, once it makes any investigations as to particular site condition, to make public this information. Yet, taking the view of the lower court in *Wunderlich* and its predecessors, the state thereby becomes entrapped, since it cannot protect itself by any contract provisions disclaiming responsibility for such information.

Thus, the effect of the courts' refusal to uphold express disclaimer clauses in construction contracts can be to eliminate the primary benefit to be derived from a public bidding system, which is to enable public agencies to spend the least possible on construction projects consistent with good quality work and material.³⁵ In effect, the failure to recognize express language in the contract rewards the

³³ A. Teichert & Son, Inc. v. State, 238 Cal. App. 2d 736, 755, 48 Cal. Rptr. 225, 238 (1965).

³⁴ Leal v. United States, 276 F.2d 378 (Ct. Cl. 1960); General Casualty Co. v. United States, 130 Ct. Cl. 520, 127 F. Supp. 805 (1955); Ranieri v. United States, 96 Ct. Cl. 494, *cert. denied*, 317 U.S. 690 (1942).

³⁵ Brief for the County of San Mateo as Amicus Curiae, p. 7, *Wunderlich v. State*, 241 A.C.A. 58, 50 Cal. Rptr. 151 (1966).

contractor's lack of diligence and non-compliance with the contract, since he will most likely receive the contract to the detriment of the other bidders while the state is made to suffer the economic consequences should a failure of conditions occur. Ironically then, carrying the system to its logical conclusion, the state can end up paying more for the project's completion than it would have had a higher or even the highest bidder been awarded the contract.

CONCLUSION

The contractor is a free agent in deciding whether to bid upon a contract;³⁶ it is apparent that the existence of protective clauses in construction contracts has not hindered bidding by private contractors. While such provisions may seem to be harsh or place the state in a position of superiority over the private party, such are the inherent necessities of the situation. The abuse which the state can be subjected to in the absence of such provisions has been amply demonstrated by the above discussion. Conversely, it has also been shown that the individual contractor will paradoxically stand less chance of successful bidding the more accurate is his bid. Surely, the purpose of the legislature in establishing the mandatory competitive bidding system, as it currently exists in California, is to abrogate such specific problems as are heretofore mentioned, and instead establish a healthy and stimulating climate in which the best interests of both the state and the conscientious contractor can best be served. The improvident proscription of exculpatory clauses in these government contract situations opens the door to those unscrupulous contractors who wish to take advantage of the judicial interpretation to be found in support of their position. Such a state of affairs can only result in the drastic alteration or complete destruction of the entire system through judicial interpretation.

Such a failure in the system will result in a greater cost to the state in addition to leaving open a wide area of discretion for the careless and unprincipled contractor. It can be argued that since all contractors will have this advantage, the state is really the final party to absorb the loss. However, if it is understood that the state will no longer be able to supply the contractors with the basic information it now supplies under the protection of the exculpatory clauses, the illusory quality of the latter statement becomes immediately apparent. A large number of small contractors would simply not be able

³⁶ *United States v. Wunderlich*, 342 U.S. 98 (1951): "Respondents were not compelled or coerced into making the contract. It was a voluntary undertaking on their part. As competent parties they have contracted for the settlement of disputes in an arbitral manner." *Id.* at 100. [This case has no relation to the *Wunderlich* case discussed throughout the comment—Ed.]

to afford to involve themselves at the elementary bidding level. They would not be able to afford the time, money, nor manpower, which has previously been supplied by the state as a mutual convenience to enhance the essential preliminary studies and investigations. Thus, what at first glance might seem to be a state of the law favorable to contractors, will if carried to its logical conclusion result in the exclusion of a large segment of these same apparent beneficiaries.

In light of such practical limitations on a state of the law which does not recognize exculpatory provisions in state construction contracts, the best interests of *both* factions require that judicial recognition be given at all times to reasonable exculpatory provisions which the parties see fit to insert in their agreement.

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