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CONSTRUCTION ATTORNEYS

Differing Site Conditions

by Bernard Kamine

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A contract must be interpreted to give effect to the mutual intention of the parties at the time of contracting (Civil Code §1636, Code of Civil Procedure § 1859); the interpretation must consider the circumstances under which the contract was made, and the matters to which it relates (Civil Code § 1647, Code of Civil Procedure § 1860). In other words, performance cannot be required, without additional compensation, if that performance was not reasonably contemplated by the parties as being within the scope of the contract at the time it was made. An early application of these principals is in *U.S. v. Utah, Nevada and California Stage Company* (1905) 199 U.S. 414, 50 L.Ed 251, 26 S.Ct. 69, where the contractor was awarded extra compensation for a scope of work far beyond what the parties had contemplated at the time of contracting. Shortly after that time, the concept was codified for certain unanticipated jobsite conditions encountered on federal government construction projects in a standard "changed conditions" clause (*Rust Engineering v. U.S.* (1938) 86 Ct. Cl. 461). In 1967, the federal

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terminology was revised to "differing site conditions" (32 Fed. Register 16268 (1967)). Both terms are used in contracts today.

Reasons for Differing Site Conditions Clauses

Besides codifying the common law for specific types of unanticipated jobsite conditions, differing site conditions clauses also facilitate allocating the risks of unforeseen conditions between the owner and the contractor.

The owner is best able to assess and avoid those risks. The owner has time for investigations, and benefits from them by using the information to refine the design. The owner employs engineers and architects to research the project and draw the plans. They get unlimited access to the site.

On the other hand, during the bidding phase a contractor has little time and limited access to the job site. Further, a contractor bids on many jobs, but is awarded few. Money spent on investigations is only recouped on the projects awarded to the contractor. So, money cannot be spent on more than a cursory investigation. The contractor must rely upon its experience and the information provided with the bidding documents.

A prudent contractor facing the risk of hitting unforeseen conditions must include contingency dollars in the bid to cover those possibilities. If nothing major is hit on the job, then the contingency money is additional profit for the contractor. On the other hand, if the owner bears the risk of unforeseen conditions, then the prudent contractor does not need those contingency dollars and can bid the lowest possible price. In that case, the owner will pay for difficult subsurface work only when it is actually required. The courts have repeatedly acknowledged these facts, *e.g.*, *Condon-Johnson & Associates v. Sacramento Municipal Utility District* (2007) 149 CA4th 1384, 1396: "The nature and accuracy of the information provided by

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the public entity manifestly bears on the risks to be undertaken by the bidder. To that extent the risk affects the amount of the bid. The more risk the greater the bid.” *Foster Const. C. A. & Williams Bros. Co. v. U. S.* (Ct.Cl. 1970) 435 F2d 873, 887: “The purpose of the changed conditions clause is thus to take at least some of the gamble on subsurface conditions out of bidding. Bidders . . . need not consider how large a contingency should be added to the bid to cover the risk. They will have no windfalls and no disasters. The Government benefits from more accurate bidding, without inflation for risks which may not eventuate. It pays for difficult subsurface work only when it is encountered and was not indicated in the logs.”

Where a contractor bears the risk of unforeseen conditions, but includes no contingency money in the bid, the contractor risks large losses, even bankruptcy, if it encounters unforeseen conditions. On those jobs the owner also risks tragedy – first, from cost-cutting measures the contractor will take if it hits unforeseen conditions, and then, from fighting contractor claims and picking up the pieces if the contractor abandons the project or goes bankrupt.

That is why most owners who regularly build construction projects will bear the risk of unforeseen conditions, through a differing site conditions clause.

Statutes, Regulations and Form Contracts

Statutes and regulations mandate differing site conditions clauses in government construction contracts. At the federal level, a clause is required in most federal construction projects by the Federal Acquisition Regulations (**FAR**), 48 CFR 36.502 and 52.236-2, and in federally funded highway projects by 23 CFR 635.109. In California, Public Contract Code section 7104 requires local public agency contracts involving excavations deeper than 4 feet to have such a clause.

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Form contracts for California state and local agencies comply with these mandates, *e.g.*, Caltrans, STANDARD SPECIFICATIONS (2010), section 4-1.06, Differing Site Conditions (23 CFR 635.109) and STANDARD SPECIFICATIONS FOR PUBLIC WORKS CONSTRUCTION (**GREENBOOK**) (2012), section 3-4, Changed Conditions.

Industry standard contracts used for both government and private construction projects also include differing site conditions clauses, *e.g.*, American Institute of Architects, AIA Document A201-2007, section 3.7.4, Concealed or Unknown Conditions; ConsensusDOCS-200 (2012), section 3.16.2, Concealed or Unknown Site Conditions; Engineers Joint Contract Documents Committee, EJDC-C700 (2013), section 4.02, Subsurface and Physical Conditions.

As with any issue involving contract interpretation, it is essential to study the differing site conditions clause in the contract. The clauses vary greatly, and, generally, what the clause says governs. Variations in differing site conditions clauses affect the determination of whether a particular situation qualifies as a differing site condition. They also prescribe different administrative procedures for notice and evaluation of the situation.

If the particular differing site conditions clause is mandated by a statute or regulation, it, too, must be checked. A clause that deviates from a statute or regulation requiring the clause cannot be less favorable to the contractor than what the statute or regulation provides.

Types of Differing Site Conditions

Traditionally, there are two types of differing site conditions: Type 1 is a condition that differs materially from the conditions indicated in the information about the job provided to bidders. Type 2 is an unknown and unusual condition that differs materially from what is ordinarily encountered on the particular type of work in the particular locality.

California Public Contract Code section 7104(a)(1) creates a 3d type of differing

site condition for local public entity projects: "material that is hazardous waste. . . [and] that is required to be removed to [certain classes of] disposal site. . ." This 3d type ensures that the owner takes responsibility for the proper disposal of hazardous wastes.

Physical Condition Existing When the Contract Was Executed

Regardless of whether it is type 1 or type 2, the differing site condition must be an actual physical condition of the job site (*Olympus Corp. v. U.S.* (Fed. Cir. 1996) 98 F3d 1314, 1318; *Bateson-Stolte, Inc. v. U. S.* (Ct.Cl. 1962) 305 F2d 386; *Hallman v. U. S.* (Ct.Cl. 1948) 80 F.Supp 370). It also must be a condition that existed at the time the contract was executed (*Olympus Corp. v. U.S.* (Fed. Cir. 1996) 98 F3d 1314, 1317; *John McShain, Inc. v. U.S.* (Ct.Cl. 1967) 375 F2d 829, 833; but see *Hoffman v. U.S.* (Ct.Cl. 1964) 340 F2d 645, 648-51, using the notice to proceed date instead of the contract date). Acts of God are not differing site conditions (*Turnkey Enterprises, Inc. v. U. S.* (Ct.Cl. 1979) 597 F2d 750), unless they combined with other unforeseeable conditions (*John A. Johnson Contr. Corp. v. U.S.* (Ct.Cl. 1955) 132 F.Supp 698). Thus, groundwater at a higher level than is shown on the geotechnical report, which was caused by unusually heavy rain before bid day, is not a differing site condition; however, higher groundwater which was caused by an upstream dam overflowing before bid day could be a differing site condition, even if the overflow was caused by unusually heavy rain.

Material Difference from Conditions Indicated or Ordinarily Encountered

Regardless of whether it is type 1 or type 2, the differing site condition must be "materially different" from the conditions indicated in the information about the job provided to bidders (type 1) or from the kind of conditions ordinarily encountered on the particular type of work in the particular locality (type 2). Materiality usually turns upon the unique facts existing on the particular job. Facts that often bear on the question of materiality are: (a) differences in

the quality of the substances encountered, (b) differences in the quantity of work required as a result of the condition, or (c) changes in the construction techniques required in order to deal with the condition. Regardless of whether the word "material" appears in the differing site conditions clause, the difference must be material to invoke the clause or for denial of the claim to amount to a breach of contract (*Murray's Iron Works, Inc. v. Boyce* (2008) 158 CA4th 1279, 1298).

Site Inspection

Regardless of whether a type 1 or type 2 differing site condition is claimed to exist, it does not qualify if the condition could have been discovered in a reasonable site inspection. Most contracts have clauses requiring the contractor to inspect the site to determine the scope of the work and the difficulties to be encountered, and to assume the risks of what could have been discovered by that inspection (*e.g.*, AIA Document A201-2007, section 3.2, Review of Contract Documents and Field Conditions by Contractors; FAR, 48 CFR 52.236-3; Caltrans STANDARD SPECIFICATIONS (2010), section 2-1.30, Job Site and Document Examination).

However, even if no site inspection was made, a differing site condition claim will only be defeated if the condition would have been discovered in a reasonable site inspection by the contractor (*Vann v. U.S.* (Ct.Cl. 1970) 420 F2d 968). A "reasonable inspection" is different for a type 1 differing site condition than for a type 2. For a type 1, it is a reasonable walk through the site (*Stock & Grove, Inc. v. U.S.*, (Ct.Cl. 1974) 493 F2d 629). For a type 2, it is a reasonable site investigation based upon the lack of any indications or representations concerning the site conditions in the owner-provided information (*McMullan & Sons, Inc. v. U.S.* (1980) 226 Ct.Cl. 565). In both cases, the test is what a reasonably competent contractor in the appropriate trade would have seen -- not what an expert in the particular condition would have

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discovered (*Ets-Hokin Corp. v. U.S.* (Ct.Cl. 1970) 420 F2d 716).

Disclaimers and Other Contract Language

Disclaimer clauses appear in most contracts. Typically they purport to limit owner responsibility for certain owner-provided information, like soils reports and boring logs, asserting that the contractor must rely upon information the contractor develops, not upon the information provided by the owner (*e.g.*, GREENBOOK, section 2-7, Subsurface Data). From such clauses, owners argue that material differences between the disclaimed information and actual job conditions cannot be the basis for a differing site conditions claim.

For policy reasons (*e.g.*, California Civil Code sections 1667, 1668 and 1670.5), and under technical rules of contract interpretation, the courts usually hold that the specific language of the differing site conditions clause governs over any general disclaimers or other general exculpatory language in the contract (*Morrison-Knudsen Co. v. U.S.* (Ct.Cl. 1968) 397 F2d 826; *Umpqua River Navigation Co. v. Crescent City Harbor Dist.* (9th Cir. 1980) 618 F2d 588; *Jack B. Parson Constr. Co. v. Utah* (Utah 1986) 725 P.2d 614; *Metropolitan Sewerage Com'n v. R. W. Constr., Inc.* (Wis 1976) 241 NW2d 371, and *Foster Const. C. A. & Williams Bros. Co. v. U. S.* (Ct.Cl. 1970) 435 F2d 873, 888: “Even unmistakable contract language in which the Government seeks to disclaim responsibility for drill hole data does not lessen the right of reliance. The decisions reject, as in conflict with the changed conditions clause, a ‘standard mandatory clause of broad application,’ [including] the variety of such disclaimers of responsibility – that the logs are not guaranteed, not representations, that the bidder is urged to draw his own conclusions. [citations]”). On the other hand, specific limited disclaimers have occasionally been effective (*Smith Contracting Co. v. U.S.* (Ct.Cl. 1969) 412 F2d 1325).

The covenant of good faith and fair dealing also has been invoked to preclude narrow interpretations of contract language that would gut the differing site conditions clause,

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even in design-build contracts where the contractor assumed site investigation and design responsibilities (*Metcalf Construction Company, Inc. v. United States* (2014) 742 F.3d 984).

In California, the courts have rejected efforts to circumvent the differing site conditions clause with disclaimers (*Condon-Johnson & Associates v. Sacramento Municipal Utility District* (2007) 149 CA4th 1384, 1387 & 1396: "Since the disclaimers wholly denied responsibility for the subsurface conditions indicated, in violation of [the statute mandating the differing site conditions clause], they were properly excluded from jury consideration. . . . [¶] [E]ven under the law preceding [that statute], a general disclaimer could not overcome positive assertions of fact regarding subsurface conditions upon which the contractor was entitled to rely. (See *E. H. Morrill Co. v. State of California, supra*, 65 Cal.2d at p. 793.) Adjusting the *Morrill* analysis to substitute the required statutory standard of "indicated" for positive assertions of fact, the disclaimer in this case is precisely the kind of general disclaimer condemned in the *Morrill* case.").

Some differing site conditions clauses restrict a type 1 claim to the material difference between the conditions encountered and information provided in the "contract documents." Owners then provide information for bidding purposes (*e.g.*, soils reports and borings logs), but declare that the information is not part of the "contract documents" so that they can argue that this information cannot be the basis for a Type 1 differing site condition. This theory has met with mixed success in federal courts (argument rejected, *Columbia v. Paul & Howard Co.* (8th Cir. 1983) 707 F2d 338; argument accepted, *P. J. Maffei Bldg. Wrecking Corp. v. U.S.* (Fed.Cir. 1984) 732 F2d 913). In California, the legislature and courts have squelched these efforts to circumvent the differing site conditions clause (*Condon-Johnson, supra*, rejected such an argument, and California Public Contract Code section 7104 was amended in 2006 to define a type 1 differing site condition as: "Subsurface or latent physical conditions at the site

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differing from those indicated by information about the site made available to bidders prior to the deadline for submitting bids").

Notice to the Owner

Regardless of whether it is type 1 or type 2 differing site condition, every differing site conditions clause requires the contractor to give the owner notice of the claim before the condition is disturbed. That notice is designed to allow the owner to determine whether a differing site condition exists and, if so, how to handle it (*Schnip Bldg. Co. v. U.S.* (Ct.Cl. 1981) 645 F2d 950).

Even though most of the differing site conditions clauses call for written notice to the owner, the federal courts have accepted oral notice if the contractor can prove it was given (*Shepherd v. U.S.* (Ct.Cl. 1953) 113 F.Supp 648). They have also refused to foreclose a differing site conditions claim despite the lack of proper notice, if the owner otherwise obtained knowledge of the condition (*S. Kane & Sons, Inc.* 78-1 BCA ¶ 13,100) or if the owner suffered no prejudice from the lack of notice (*Parcoa Inc.* 77-2 BCA ¶ 12,658). California courts should do the same thing, by construing the notice requirement as a covenant, not a condition (Civil Code §§ 1436 & 1636; Code of Civil Procedure § 1859; *Yamanishi v. Bleily & Collishaw, Inc.* (1972) 29 CA3d 457), by construing it liberally to avoid the forfeiture of a legitimate claim (Civil Code §§ 1442 & 1670.5; *Hawley v. Orange County Flood etc. Dist.* (1963) 211 CA2d 708), by exercising the court's equitable power to excuse a condition that would cause a forfeiture (Civil Code §§ 3275 & 3369; *O'Morrow v. Borad* (1946) 27 C2d 794), or by finding that notice was waived (Civil Code §§ 3513 & 3515; *Weeshoff Constr. Co. v. Los Angeles County Flood etc. Dist.* (1979) 88 CA3d 579).

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Contractual Right to Change Order

If a differing site condition exists, then, under most differing site conditions clauses, the contractor has a contractual right to a change order or equitable adjustment or contract modification - whatever the terminology is in the particular contract. In that change order, the contractor should be compensated for all of the effects of the differing site condition, including overhead, profit and time extensions. Under state law, the failure to issue that change order amounts to a breach of the contract.

Proving a Type 1 Differing Site Condition Claim

The typical differing site conditions clause defines a type 1 differing site condition as: (1) a subsurface or latent physical condition at the site, (2) differing materially from what was indicated in the bidding information. If the owner fails to recognize the differing site condition by issuing a change order, the contractor must pursue the appropriate dispute resolution procedure (arbitration, trial, or administrative court, depending upon the contract). In California, the contractor must prove (1) a subsurface or latent physical condition at the site, (2) differing materially (3) from what was indicated in the bidding information. What was "indicated" can be either a positive statement about the condition in the bidding information, or an inference about the condition arising from that information (*Condon-Johnson & Associates v. Sacramento Municipal Utility District* (2007), *supra*, 149 CA4th 1384, 1393-95).

Although California courts look to federal public contract law for guidance in dealing with state and local public contract law, there appears to be a fundamental difference between California contract law and federal law. Under federal law "It is well settled that where a contractor seeks recovery based on his interpretation of an ambiguous contract, he must show that he relied on this interpretation in submitting his bid' [citations]" (*Lear Siegler Management Services Corp. v. U.S.* (Fed. Cir. 1989) 867 F2d 600, 603). To ascertain such reliance, a court

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must inquire into how the contractor intended to perform the contract at the time it bid the job. That would mean looking at the contractor's state of mind or belief at bid time, as reflected, for example, in the estimate on which the bid was based. That is subjective evidence of the contractor's intent, not the objective evidence manifested in the language of the contract. Moreover, such subjective intent is not communicated to the owner, except perhaps as it might be shown in the bid form actually submitted.

In California such evidence is irrelevant to the determination of a type 1 differing site condition. "Determining whether the contract and related documents indicated the subsurface conditions at the jobsite . . . is a matter of contract interpretation . . ." (*Condon-Johnson & Associates v. Sacramento Municipal Utility District* (2007) 149 CA4th 1384, 1395). "A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful" (California Civil Code section 1636). "[T]he parties undisclosed intentions would not have become part of the contract. 'The mere state of mind of the parties is not the object of inquiry. The terms of the contract are determinable by an external, not by an internal standard--or by what has been termed the objective rather than the subjective test.' [citation]" (*Patel v. Liebermensch* (2008) 45 C4th 344, 352, 86 CR3d 366, 197 P3d 177).

In California, the failure to properly recognize a differing site condition and issue a change order is a breach of contract. In a claim for breach of contract there is no reliance element outside of what is in the contract itself or ascertained by an objective test. Either the party performed as required by the contract (interpreted by an objective standard), or not. As a general rule, if a contractor misreads the plans and specifications, thereby underbidding the job, the contractor is stuck, it is obligated to perform per the contract at the contract price. The contractor cannot assert its subjective intent, based upon its mistake, as a ground for an increase

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in the contract price; the owner gets the benefit of the lower contract cost that resulted from the contractor's mistake. Conversely, if the contractor's mistake resulted in a higher bid than should have been submitted, the owner is stuck, it is obligated to pay the contract price, and the contractor gets the benefit of lower cost (and increased profits) resulting from meeting the actual contract requirement. The same obtains for a type 1 differing site condition. The contractor's reliance on any interpretation of the plans and specification at bid time is irrelevant, as is the estimate on which the bid was based. The test is whether, based upon an objective standard, the conditions encountered differ materially from those indicated in pre-bid, owner-provided information.

Proving a Type 2 Differing Site Condition Claim

As a general rule, a type 2 differing site condition is harder to establish than a type 1 (*Charles T. Parker Constr. Co. v. U. S.* (Ct.Cl. 1970) 433 F2d 771). The typical differing site conditions clause defines a type 2 differing site condition as: (1) a physical condition, (2) that is unknown, (3) that is unusual, (4) that differs materially from what is ordinarily encountered and generally recognized as inherent in the specified work. It must be an unusual condition for that locality, but need not be a geological freak (*Western Well Drilling Co. v. U. S.* (N.D.Cal. 1951) 96 F.Supp 377). What is unusual, ordinarily encountered, and generally recognized can all be determined by an objective test. However, what is "unknown" to the contractor can only be determined by an inquiry into what the contractor actually knew at bid time - based not only on the information provided by the owner, but also on any other source of information from which the contractor gained knowledge about the conditions likely to be encountered, including the contractor's own pre-bid investigation and previous experience in the locality.

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Alternative Legal Theories

Contractors have alternative routes to recovery in many of the situations addressed by a differing site conditions clause. The two most often used are (1) breach of the implied warranty that the plans and specifications are correct and (2) non-disclosure of material facts. The former is a breach of contract; the latter, although characterized as a breach of contract to circumvent sovereign immunity issues, requires the same proof as the tort of misrepresentation.

The implied warranty is often called the Spearin doctrine, after *United States v. Spearin* (1918) 248 U.S. 132, 136, which held: "But if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications. [citations] This responsibility of the owner is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work." In California, the theory was most recently described in *G. Voskanian Construction, Inc. v. Alhambra Unified School District* (2012) 204 CA4th 981, 992: "It is settled law that 'A contractor of public works who, acting reasonably, *is misled by incorrect plans and specifications* issued by the public authorities as the basis for bids and who, as a result, submits a bid which is lower than he would have otherwise made *may recover in a contract action for extra work or expenses necessitated by the conditions being other than as represented.* [Citations.] This rule is mainly based on the theory that the furnishing of misleading plans and specifications by the public body constitutes a breach of an implied warranty of their correctness.' [italics in the original]"

The non-disclosure theory appeared on the federal level in *Hollerbach v. United States* (1914) 233 U.S. 165, 171-72, holding: "We think this positive statement of the specifications must be taken as true and binding upon the Government, and that upon it rather

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than upon the claimants must fall the loss resulting from such mistaken representations." In California, it is explained in *Warner Construction Corporation v. City of Los Angeles* (1970) 2 Cal. 3d 285, 294: "A fraudulent concealment often composes the basis for an action in tort, but tort actions for misrepresentation against public agencies are barred by *Government Code section 818.8*. Plaintiff retains, however, a cause of action in contract. 'It is the general rule that by failing to impart its knowledge of difficulties to be encountered in a project, the owner will be liable for misrepresentation if the contractor is unable to perform according to the contract provisions.' [citation] [¶] . . . a cause of action for non-disclosure of material facts may arise in at least three instances: [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; [3] the defendant actively conceals discovery from the plaintiff."

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