

April 16, 1999

To: Board of Directors (Engineering and Operations Committee—Information)

From: General Manager _____

Submitted by: Gary M. Snyder
Chief Engineer _____

Subject: AB 1504 (Margett) Public Contract Termination

RECOMMENDATION

For information only.

EXECUTIVE SUMMARY

AB 1504 (attached) would eliminate a public entity's ability to terminate a contract for convenience. The bill provides that a public entity may terminate a contract only in the event that a contractor has failed to properly prosecute the work with the diligence and force specified by the contract. The bill also provides that, if a public entity terminates or attempts to terminate a contract for any other reason, the contractor is deemed to have completed its obligations under the contract, all claims submitted by the contractor at the time of the termination are deemed to be valid, and the public entity is liable for payment for the completion of the contract and any claims submitted by the contractor at the time of the termination.

DETAILED REPORT

Most public construction contracts, including Metropolitan's, include provisions which permit the owner to terminate the contract for failure of the contractor to fulfill its contract obligations, as well as provisions which permit the owner to terminate the contract for its own convenience. While infrequently used, termination for convenience provisions might be invoked in situations where, through no fault of the contractor, it is no longer advisable to complete the contract. For example, if a major earthquake were to severely damage an ongoing project, or if financial, environmental, or legal actions necessitated a cessation of the work, an owner might consider terminating the contract for convenience in order to mitigate its losses. Termination for convenience provisions generally provide that a contractor be paid for costs incurred to the date of termination, plus reasonable overhead and profit.

If enacted, AB 1504 would remove a public entity's contractual right to terminate a contract for convenience. Under the bill, a public entity may only terminate a contract if the contractor has failed to provide an adequate work force or material of proper quality, has failed to comply with provisions relating to payment of subcontractors, or otherwise has failed to meet its contractual obligations. In the event that other conditions arose during prosecution of the work that made it

impossible or undesirable to proceed, a public entity would be prohibited from terminating the contract. This is a restriction that is not imposed upon owners in the private sector.

AB 1504 also provides for a severe penalty if a public entity terminates or attempts to terminate a contract for reasons other than those permitted by the bill. In that event, the contractor is deemed to have completed its obligations under the contract; all claims submitted by the contractor at the time of the termination or attempted termination are deemed to be valid; and the entity is liable for payment for completion of the contract and any claims submitted at the time of the termination, regardless of the state of completion of the contract. If, say, a contract were only 10 percent complete at the time an owner terminated the contract for convenience, the contractor would be entitled to full payment of the remaining unpaid balance of the contract, even though he would be excused from performing the remainder of the work. Deficient work performed prior to the termination would not have to be corrected.

Finally, the language which deems all claims to be valid could cause a public entity to pay for unsubstantiated or frivolous contractor claims. All claims are currently evaluated for both entitlement (the contractor is legally entitled to additional compensation) and cost (the dollar amount sought by the contractor reflects the actual amount of its damages). Both items must be valid before the public entity is liable for payment. The bill would encourage contractors to file exaggerated and inflated claims without recourse to any challenge by the public entity.

Both the Association of California Water Agencies and the California Municipal Utilities Association have taken a position of opposition to AB 1504.

DCS/fln/mg:rev1

Attachment 10-23A

Attachment 10-23A

**The following 2 pages are attachments to
Board Letter Item 10-23**

ASSEMBLY BILL

No. 1504

Introduced by Assembly Member Margett

February 26, 1999

An act to add Section 7102.5 to the Public Contract Code, relating to public contracts.

LEGISLATIVE COUNSEL'S DIGEST

AB 1504, as introduced, Margett. Public contract termination: cause.

Under existing law, the Director of General Services may terminate a contract after giving the contractor written notice of the defaults to be remedied. The director may terminate if the contractor has failed to provide an adequate work force or material of proper quality, has failed to comply with provisions relating to payment of subcontractors, or otherwise failed to meet contractual obligations.

This bill would provide that a public entity, defined to include local government entities, can terminate a contract only for the reasons discussed above, and would provide penalties for termination or attempted termination of contracts for other reasons.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 7102.5 is added to the Public
2 Contract Code, to read:

1 7102.5. (a) A public entity may terminate a contract
2 only for cause as defined in Section 10253.

3 (b) If a public entity terminates or attempts to
4 terminate a contract without cause, the following shall
5 occur:

6 (1) The contractor is deemed to have completed its
7 entire obligations under the contract.

8 (2) All claims submitted by the contractor at the time
9 of the termination or attempted termination are deemed
10 to be valid.

11 (3) The entity is liable for payment for completion of
12 the contract and any claims described in paragraph (2).

