



School Business Law Update

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ATTORNEYS' FEES CLAUSE IN ONE PORTION OF CONSTRUCTION PROJECT DOCUMENTS MAY MEAN IT APPLIES TO THE CONSTRUCTION CONTRACT

On November 2, 2010 the Fourth District Court of Appeal, Division One decided the case of Saddleback Valley Unified School District v. Mepco Services, Inc. (2010) 189 Cal. App. 4th 1027.

BACKGROUND

This case arose from a dispute between Mepco, a general contractor, and Saddleback Valley Unified School District ("District") regarding a school modernization project. Mepco bid on the project based on plans provided by an architectural firm that District had hired, and was eventually awarded the \$1.64 million contract.

During construction, Mepco encountered a number of problems that required it to request approval for additional work that it had not originally contemplated based on the plans. In addition to encountering unforeseen conditions at the site, Mepco belatedly discovered that certain aspects of the Project plans that it had relied upon in bidding on the Project required approvals or permits from various governmental agencies, and that these approvals and permits had not been obtained before construction began. Mepco performed the additional work after being directed to do so by representatives of the District. After Mepco completed the additional work, Mepco and the District disagreed as to whether Mepco was entitled to be paid for the work, and whether Mepco was entitled to an extension of time to complete the contract, or instead, would be liable for liquidated damages as a result of the delay.

The parties were unable to resolve their differences and Mepco sued for breach of contract among other things. The District counter-sued Mepco and Hartford Fire Insurance Company, the payment and performance bond provider, claiming that Mepco had breached the contract and sought liquidated damages for Mepco's delay in completing the project. After a nearly two-week jury trial, Mepco was awarded \$681,086.55, plus interest of \$189,479.89, \$366,916.93 in attorneys' fees, and \$208,650.26 in costs for a total award of \$1,446,133.50, plus judgment against the District on its cross-complaint against Mepco and Hartford.

APPELLATE CASE

The District appealed from the judgment citing numerous errors. One of the errors alleged was the awarding of attorneys' fees to Mepco. The District argued that Mepco was not entitled to attorneys' fees under Public Contract Code Section 7107 (f)¹ or the terms of the performance bond containing the reciprocal attorneys' fee provision of Civil Code section 1717 (a).² The Appellate Court held that the construction contract did not include an attorneys' fee provision. However, pursuant to the contract, the performance bond was a part of the project documents required by the District. The court ruled that by raising the bond in its countersuit, the District made the action one "on the bond." The court went on to state that the breach of contract claims of the parties were so intertwined with the District's breach of performance bond cause of action that a finding of liability on the part of Mepco was a prerequisite to the District recovering under the bond. Therefore, if the District had prevailed on its claim to enforce the bond, Hartford and Mepco would have been liable to it for the attorneys' fees it incurred in litigating all of the claims in this case. Under the court's reasoning, Civil Code section 1717's reciprocal provision operated to make the District liable for the attorneys' fees that Hartford and Mepco incurred in defending against the District's prosecution of the action to enforce the bond. Ultimately the court held that because the question of who was at fault for the delay was central to the District's performance bond claim, Mepco was entitled to the attorneys' fees that it incurred with respect to that issue as well.

Perhaps the most interesting aspect of the case was that on November 22, 2010 the Appellate Court modified the decision by adding footnote 26 which reads as follows:

¹ PCC Section 7107(f) states: (f) In the event that retention payments are not made within the time periods required by this section, the public entity or original contractor withholding the unpaid amounts shall be subject to a charge of 2 percent per month on the improperly withheld amount, in lieu of any interest otherwise due. Additionally, in any action for the collection of funds wrongfully withheld, the prevailing party shall be entitled to attorney's fees and costs.

² CC Section 1717(a) provides in relevant part: (a) In any action on a contract, where the contract specifically provides that attorney's fees and costs, which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney's fees in addition to other costs.

Civil Code section 1717, subdivision (a) also states: “Where a contract provides for attorney's fees, as set forth above, that provision shall be construed as applying to *the entire contract*, unless each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract.” (Italics added.) Neither party raises an argument about this portion of the statute on appeal. We therefore express no opinion with respect to the potential applicability of this portion of the statute to the issues in this case.”

Although the court did not decide the issue it raised in the footnote, the inclusion of the footnote could signal that if presented with this issue in the future, the court would be inclined to broadly construe an attorneys fee provision in an ancillary document to the construction agreement as applying to the entire document, “unless each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract.” Moreover, if the italicized phrase of Civil Code section 1717 in the footnote were to be interpreted literally, an ancillary attorneys’ fee provision could be found to apply to the construction agreement whether the document containing it was sued on or not.

This could have far reaching implications for school districts executing maintenance or other construction project contracts where bonds (which routinely contain attorneys’ fee provisions) are required, counsel are not routinely involved and where contract forms do not specify what, if any, involvement the parties’ counsel had in negotiating or executing the contracts.

If you have any questions concerning this or related issues, do not hesitate to contact our office.

- Christopher P. Burger

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