

Item 8
File 11-0154
(continued from March 2, 2011)

Department:
 Department of Public Works; City Attorney's Office

EXECUTIVE SUMMARY

Legislative Objective

- The proposed ordinance would appropriate \$2,809,000 from the General Fund Reserve to the Department of Public Works (DPW) for litigation expenses related to Mitchell Engineering/Obayashi Corporation v. City and County of San Francisco, for the Fourth Street Bridge Project, including (a) \$300,000 for DPW's staff to assist the City Attorney's Office with litigation, and (b) a \$2,509,000 DPW work order with the City Attorney's Office for the provision of legal services.

Key Points

- On March 10, 2003, after a competitive bid process, DPW awarded a \$16,978,570 construction agreement to Mitchell Engineering and the Obayashi Corporation (MEOC), a Joint Venture, for MEOC to construct the Fourth Street Bridge Project. Subsequent change orders by DPW increased the construction agreement to \$21,682,307. MEOC did not complete construction until May 1, 2006, which was 555 days subsequent to the required completion date of October 23, 2004.
- On February 28, 2008, MEOC filed a lawsuit against the City for an amount not less than \$20,000,000 to recover additional costs that MEOC alleges to have incurred to complete the Fourth Street Bridge Project. Subsequently, the City Attorney filed a cross-complaint against MEOC and Arch Insurance Company, MEOC's surety bond provider, for breach of contract and the recovery of liquidated damages totaling \$14,115,000 for the delay in completing the Fourth Street Bridge Project. All attempts at mediation and settlement have been unsuccessful.

Fiscal Impacts

- If approved, this supplemental appropriation request of \$2,809,000 would reduce the City's General Fund Reserve, from the original FY 2010-2011 funding level of \$25,000,000 to \$22,191,000.
- A combined total of approximately \$319,740, or 11.4 percent of the requested \$2,809,000 is projected to be expended by the City Attorney (\$250,000) and DPW (\$69,740) retroactive from December 1, 2010 through March 8, 2011, such that the proposed ordinance should be amended to provide for retroactivity.
- Although the City Attorney considers the expenditures of the trial preparation and the forthcoming trial by the City Attorney's Office and DPW to be privileged and confidential, the City Attorney and DPW will provide such details to the Budget and Finance Committee on a confidential basis, if requested.

Recommendations

- Amend the proposed ordinance to provide for retroactivity.
- Approval of the proposed ordinance, as amended, is a policy decision for the Board of Supervisors.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

In accordance with Section 9.105 of the City Charter, subject to the Controller's certification of the availability of funds, the Board of Supervisors or the Mayor may initiate amendments to the annual appropriations ordinance, which must be subsequently approved by the Board of Supervisors.

Background

The Board of Supervisors appropriated a total of \$42,056,978 from Federal, State, and local funding sources for the Department of Public Works (DPW) to construct the Fourth Street Bridge Project, in six previous DPW annual budgets (FYs 1999-2000, 2000-2001, 2004-2005, 2005-2006, 2006-2007, and 2007-2008), and seven previously approved legislative items (Resolutions 453-02, 132-01, 1158-99, 0096-03, 070-03; Ordinances 50-06 and 60-05).

Work on the Fourth Street Bridge Project, located on Fourth Street between Channel Street and Berry Street, includes (1) seismic retrofitting, (2) installing a redesigned counterweight¹, (3) integrating rails for the Third Street Light Rail Project, to provide light rail service between Downtown and the Third Street Corridor, (4) refurbishing the Bridge's watchman and operator houses, (5) upgrading the mechanical, electrical, and control systems, (6) replacing the steel deck, and (7) repaving the approach spans and surrounding areas of the Fourth Street Bridge.

On March 10, 2003, subsequent to a competitive bid process, DPW awarded an initial \$16,978,570 construction agreement² to Mitchell Engineering and the Obayashi Corporation (MEOC), a Joint Venture, for MEOC to construct the Fourth Street Bridge Project. DPW added change orders totaling \$4,703,737 to the MEOC construction agreement, which increased the total construction agreement to \$21,682,307, in order to provide additional steel rehabilitation, a heavier-weight counterweight, the removal of timber piles³, and the reconstruction of the abutment⁴ supporting the south end of the Fourth Street Bridge. Approval of the original \$16,978,570 construction agreement was not required by the Board of Supervisors because pursuant to Section 9.118(b) of the City Charter, construction agreements are not subject to Board of Supervisors approval. Approval of the \$4,703,737 in change orders, in accordance with Section 6.22(H) of the City's Administrative Code was subject to approval by the Mayor and the Controller. All funds for the Fourth Street Bridge Project were subject to appropriation approval by the Board of Supervisors.

¹ The Fourth Street Bridge is a drawbridge that uses a counterweight to raise and lower the drawbridge.

² In addition to the initial \$16,978,570 construction agreement, DPW budgeted a ten percent construction contingency of \$1,697,857 for the Fourth Street Bridge Project. A total of \$4,703,737 in change orders, which included the \$1,697,857 construction contingency, was added to the MEOC construction agreement, increasing the total construction agreement to \$21,682,307.

³ Timber piles are cylindrical timber columns driven into the channel bottom (bay mud and bedrock) to support the vertical load of the Bridge.

⁴ An abutment supports the end of the bridge, such that the bridge loads are transferred to the foundation.

Construction of the Fourth Street Bridge Project commenced on April 28, 2003 and was completed on May 1, 2006, approximately three years later, which was 555 days subsequent to the required completion date of October 23, 2004.

The Fourth Street Bridge re-opened to traffic on September 1, 2006. Ms. Peg Divine, Deputy Manager of the Bureau of Engineering at DPW, states that because MEOC could not provide bridge operations training to DPW's bridge operators until after 60 days of completing construction, the Fourth Street Bridge re-opening was delayed until September 1, 2006.

As a result of construction delays, MEOC claimed that it incurred costs of \$21,470,436 in excess of the \$21,682,307 which was previously paid by DPW to MEOC under the construction agreement. In March and May of 2006, MEOC and DPW entered into two separate mediations to resolve MEOC's claims. According to Ms. Louise Simpson of the City Attorney's Office, MEOC's and DPW's attempts to mediate the dispute were unsuccessful.

Subsequently, on February 29, 2008, MEOC filed a lawsuit against the City in an amount not less than \$20,000,000, to recover its additional costs of \$21,470,436 that MEOC alleges it incurred and was not paid by the City, plus penalties and interest. Subsequently, the City Attorney's Office filed a cross-complaint against MEOC and Arch Insurance Company, MEOC's surety bond provider⁵, for breach of contract and the recovery of liquidated damages totaling \$14,115,000 because of the 555-day delay caused by MEOC in completing the Fourth Street Bridge Project.

After continued unsuccessful attempts to settle the City's and MEOC's claims, MEOC proceeded with its lawsuit against the City. As a result, Ms. Simpson states that the City Attorney and DPW are requesting \$2,809,000 of additional General Fund monies at this time in order to provide legal services to defend the City in this case.

On January 28, 2011, the Santa Clara Superior Court⁶ cancelled the original trial date of May 31, 2011 and scheduled a trial setting conference on March 11, 2011 to set a new trial date. Ms. Simpson advises that while the trial may commence as early as June 2011 and end in August 2011, based on an anticipated trial length of 12 weeks, the trial is more likely to occur in the fall of 2011, during FY 2011-2012.

DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would appropriate \$2,809,000 from the City's General Fund Reserve to DPW for litigation expenses related to the Santa Clara Superior Court case, Mitchell Engineering/Obayashi Corporation v. City and County of San Francisco, pertaining to the Fourth Street Bridge Project. Of the total requested \$2,809,000 supplemental appropriation, (a) \$300,000 would pay for DPW's staff to assist the City Attorney's Office, including providing

⁵ Arch Insurance Company provided the City's required surety bonds for the Fourth Street Bridge Project. The surety bonds required Arch Insurance to guarantee completion of the Project and payment of the subcontractors and vendors, in the event that MEOC failed to complete the Project.

⁶ Bay Area Reinforcing, Inc., MEOC's subcontractor, originally filed a lawsuit in the Superior Court of San Mateo County against MEOC because Obayashi Corporation, a joint venture partner, had its principal place of business in San Mateo County. MEOC then filed a cross-complaint against the City in San Mateo County. The City subsequently filed a cross-complaint against MEOC and Arch Insurance, and filed a motion to change the venue to a neutral location, which was granted, and the Superior Court of San Mateo County moved the trial to Santa Clara County.

information for (i) discovery responses, (ii) deposition preparation, and (iii) other trial preparation, and (b) the remaining \$2,509,000 would pay for a DPW work order with the City Attorney's Office for the City Attorney's costs, including (i) City Attorney staff, (ii) written discovery, (iii) document scanning, coding, and production, (iv) witness depositions, (v) trial motions, (vi) trial audio/visual preparation, (vii) travel costs, and (viii) trial (expected 12 week length).

According to Ms. Simpson, the City Attorney considers the detailed plans for the trial preparation and trial by the City Attorney's Office and DPW, and the related expenditures, to be privileged and confidential. As such, Ms. Simpson provided the Budget and Legislative Analyst, on a confidential basis, with a budget for the subject requested \$2,809,000 supplemental appropriation. Ms. Simpson advises that the City Attorney would also provide such budget details to the Budget and Finance Committee on a confidential basis, if the Budget and Finance Committee makes such a request.

In December of 2010, the Santa Clara Superior Court set an original trial date for May 31, 2011. The City Attorney and DPW began trial preparation for the case on approximately December 1, 2010, subsequent to continued unsuccessful attempts to settle the City's and MEOC's claims. Subsequently, MEOC proceeded with its lawsuit against the City. As a result, the City will expend an estimated \$319,740, or 11.4 percent of the requested \$2,809,000, including an estimated \$250,000 by the City Attorney's Office and an estimated \$69,740 by DPW, for the period retroactive to December 1, 2010 through March 8, 2011 for costs related to the litigation.

Therefore, the proposed supplemental appropriation ordinance should be amended to provide for retroactive authorization of expenditures.

FISCAL IMPACTS

The proposed supplemental appropriation request of \$2,809,000 would be funded with monies from the City's \$25,000,000 General Fund Reserve. If the proposed \$2,809,000 supplemental appropriation request is approved, the City's \$25,000,000 General Fund Reserve would be reduced to \$22,191,000.

In response to inquiries by the Budget and Legislative Analyst regarding the use of alternative funding sources other than the General Fund Reserve for the subject supplemental appropriation, according to Ms. Divine, although Federal, State, and local sources funded the Fourth Street Bridge Project, such funds cannot be expended on the subject litigation expenses because (1) the use of the Federal and State funds is limited by Federal and State regulations and (2) the remaining local funds of an estimated \$85,000, all City General Fund monies, cannot be expended because the California State Department of Transportation (Caltrans) has not conducted its audit of the Fourth Street Bridge Project and may find some Project expenditures ineligible for Federal and State Highway funding. Furthermore, Ms. Monique Zmuda, Deputy City Controller, states that the City's FY 2010-2011 \$11,000,000 General Fund Litigation Reserve is not being proposed to fund the subject supplemental appropriation because the Litigation Reserve is generally used to pay for judgments, claims, and settlements. According to Mr. Leo Levenson, the Controller's Director of Budget, Analysis, and Reconciliation, as of the writing of this report, the Litigation Reserve has a FY 2010-2011 balance of \$2,800,000.

The Budget and Legislative Analyst notes that given that the anticipated trial is not scheduled to begin until June of 2011, and possibly later, a portion of the unexpended amount of \$2,489,260 (\$2,809,000 requested less \$319,740 to be expended through March 8, 2011) will likely be expended in FY 2011-2012. Mr. Levenson advises that any unexpended funds, as of June 30, 2011, from the requested \$2,809,000 supplemental appropriation would automatically carry-forward from FY 2010-2011 to FY 2011-2012. In the event that there are unexpended funds at the conclusion of litigation, Mr. Levenson states that such funds would be returned to the City's General Fund.

The City Attorney's Office and DPW also advise that, in addition to this subject request of \$2,809,000, an estimated additional \$1,236,991 in General Fund monies, including \$1,075,000 for the City Attorney's Office and \$161,991 for DPW, associated with the subject litigation, will be requested in the City's FY 2011-2012 annual budget.

According to Ms. Divine, pursuant to the grant agreements that the City has with the various Federal, State, and local entities that funded the Fourth Street Bridge Project, any monies that the City might recover from the subject litigation would be distributed to the various Federal, State, and local entities⁷, depending on the proportion of funding each source contributed to the Fourth Street Bridge Project. To the extent that monies are returned to the City, such monies could potentially reimburse the City's General Fund⁸ up to the subject requested \$2,809,000. However, according to Ms. Simpson, the construction agreement between MEOC and DPW did not include a provision entitling the prevailing party, in a breach of contract dispute, to recover attorney's fees. Therefore, the City has no legal basis to seek recovery of its attorney's fees from MEOC in this case.

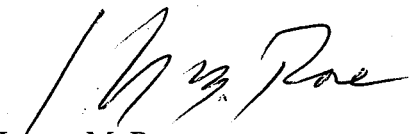
Ms. Simpson states that if the City reaches a settlement agreement or does not prevail in the subject litigation, the City will request funds from Caltrans, which administers Federal funds, up to a maximum of 80 percent, to pay any settlement or judgment amounts resulting from the subject litigation, with the remaining balance of at least 20 percent to be paid by the City, subject to appropriation approval by the Board of Supervisors.

RECOMMENDATIONS

1. Amend the proposed ordinance to provide for retroactivity.
2. Approval of the proposed ordinance, as amended, is a policy decision for the Board of Supervisors.

⁷ Local funding sources for the Fourth Street Bridge Project included City General Funds, San Francisco County Transportation Authority ½ cent Sales Taxes, Earthquake Safety Bonds, and Street Improvement Bonds.

⁸ An estimated \$3,636,750 of General Fund revenues were used to fund the Fourth Street Bridge Project.



Harvey M. Rose

cc: Supervisor Chu
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