



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Richard Doyle,
Jennifer A. Maguire,
Barry Ng

SUBJECT: SEE BELOW

DATE: January 23, 2015

SUBJECT: AUTHORITY TO NEGOTIATE AND EXECUTE A SETTLEMENT AGREEMENT FOR THE SAN JOSE ENVIRONMENTAL INNOVATION CENTER PROJECT.

RECOMMENDATION

- A. Adopt a resolution authorizing the City Attorney to negotiate and execute a final settlement agreement not to exceed \$200,000.00 with Liberty Mutual Insurance Company, the surety that completed construction of Phase II of the San Jose Environmental Innovation Center.
- B. Adopt the following 2014-2015 Appropriation Ordinance Amendments in the Integrated Waste Management Fund:
 1. Decrease the Unrestricted Ending Fund Balance in the amount of \$200,000; and
 2. Increase the EIC (Miscellaneous Funding Sources) appropriation to the Environmental Services Department in the amount of \$200,000.

OUTCOME

The recommendation will enable construction claims related to Phase II of the San Jose Environmental Innovation Center Project to be finally resolved and the Project closed so that limited staff resources can be allocated to other significant City construction projects.

BACKGROUND

There is significant background leading up to the recommended settlement. Understanding this background is important to putting the proposed settlement in the proper context.

A. Construction Contract with Applegate Johnson, Inc.

On May 31, 2011, the City Council awarded an \$11,094,935.00 construction contract for Phase II of the San Jose Innovation Center ("Project") to the low bidder Applegate Johnson, Inc. ("Applegate"). Applegate's bid was approximately 14% below the engineer's estimate. The poor economic environment at that time resulted in contractors aggressively underbidding jobs in order to obtain work.

The City Council approved a construction contingency in the amount of \$1,330,000.00 for any unforeseen contract changes needed to complete the Project.

Based on two prior City construction projects in which Applegate was the contractor, staff expressed concerns to the City Council about Applegate's ability to complete the work in a *timely* manner. However, the Project was financed through the New Markets Tax Credit program, which imposed a deadline on when the City had to award the construction contract in order to qualify for funding. In order to meet the funding deadline, the City Council – based on staff's recommendation – decided it needed to award the construction contract for the Project to Applegate despite these concerns.

The original contract completion date for the Project was December 20, 2012. Various construction delays resulted in the City and Applegate amending the contract completion date to March 15, 2013. Additional construction delays, including those resulting from the discovery and abatement of lead and asbestos, resulted in the parties establishing December 31, 2013 as a new completion date.

Despite the time extensions, Applegate's progress continued to deteriorate. Finally, on June 14, 2013, the City demanded that Applegate demonstrate significant progress on a number of specified work items. Applegate did not satisfy the demand and in early July abandoned the Project. By mid-July, Applegate had filed for bankruptcy, and the City had made a demand on the performance bond surety - Liberty Mutual Insurance Company ("Liberty") – to perform its obligations.

B. Takeover Agreement Between the City and Liberty

The negotiations between the City and Liberty were difficult.

In addition to the approximately \$2.8 million remaining in the construction contract, Liberty initially demanded an extra \$2,000,000 from the City to takeover and complete

construction of the Project. Liberty asserted that the \$2,000,000 covered the cost of City construction delays, subcontractor escalation costs and City overpayments to Applegate.

The City and Liberty ultimately entered into a takeover agreement in which Liberty agreed to complete construction of the Project. As part of the takeover agreement, the City agreed to pay Liberty the remaining contract balance of approximately \$2.8 million, a completion bonus of \$200,000 if Liberty completed the Project within a fixed time period, and a "settlement payment" of \$800,000 in order to avoid the risks associated with the City completing construction of the Project at a potential cost far in excess of \$1,000,000.

In exchange for the "settlement payment" of \$800,000, Liberty waived all claims against the City *except for a "reservation of rights" on claims relating to the following:*

- Subcontractor pass through claims
- Any defective work caused by the City
- Certain change orders proposed by Applegate before it abandoned the Project
- Reasonably unforeseeable site conditions

Liberty recommenced construction of the Project in September, 2013. Liberty subsequently completed construction of the Project in May, 2014. The City has paid all amounts due and owing under the takeover agreement, including the \$200,000 completion bonus.

ANALYSIS

Following completion of the Project, Liberty submitted to the City a statement of potential claims consisting of over 100 distinct claims. Liberty asserted that all of these claims were within the reservation of rights in the takeover agreement. Most of the claims were for escalation costs, additional costs related to lead abatement and additional compensation for storm water pollution prevention plan work.

Liberty asserted that the total value of its claims was \$701,676.35. However, Liberty stated that it was willing to accept \$413,599.34 as a settlement.

Staff's preliminary analysis of the claims concluded that the City should pay Liberty \$54,043.00 – an amount that the City has since paid to Liberty. A subsequent, more in depth analysis of Liberty's claims led staff to conclude that the City should pay Liberty an additional \$59,293.51. The City has not yet paid this amount.

On December 12, 2014, the City and Liberty had a telephone conference to discuss settling the matter. During the telephone call, Liberty suggested the parties split the

claimed amount. Following the telephone conference call, the Director of Public Works informed Liberty that he would be willing to recommend a settlement of \$200,000. Liberty accepted the offer.

As part of the settlement, Liberty would need to continue to provide any needed warranty work and any needed work to correct defective work. In addition, Liberty would also need to indemnify the City for any claims or lawsuits related to stop notices.

The proposed settlement is reasonable considering that it finally resolves a multimillion dollar construction project. The settlement is only about \$140,000 more than what the City has concluded it owes Liberty ($\$200,000 - \$59,293.51 = \$140,706.49$). This is an appropriate amount to pay to avoid the costs of litigation and to eliminate the risk the City could have to pay more following such litigation. Additionally, this settlement will enable Public Works to close out the Project so that limited staffing resources can be reallocated to other significant projects.

POLICY ALTERNATIVES

Not Applicable

PUBLIC OUTREACH/INTEREST

Not applicable.

COORDINATION

This memo has been coordinated with the Environmental Services Department.

COST SUMMARY/IMPLICATIONS

A budget action is recommended to increase the EIC (Miscellaneous Funding Sources) appropriation budget by \$200,000 to fund the settlement payment. The funds for this recommendation would come from the Integrated Waste Management Fund (Fund 423) Ending Fund Balance. A combination of three sources (one-third each) have generated the available fund balance to support this action, including: Construction and Demolition Diversion Deposit Program ineligible deposits that are not returned due to ineligibility, Recycle Plus customer fees, and Landfill AB939 fees.

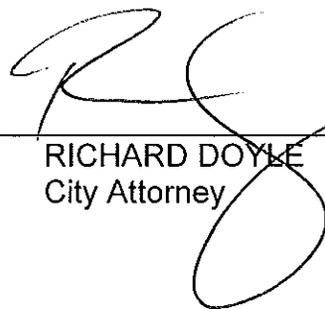
BUDGET REFERENCE

The table below identifies the fund and appropriations proposed to fund the agreement.

Fund #	Appn #	Appn. Name	Current Appn.	Recom'd Budget Action	Total	2014-15 Adopted Operating Budget	Last Budget Action (Date, Ord. #)
423	7605	EIC (Miscellaneous Funding Sources)	\$24,721	\$200,000	\$224,721	XI-50	10/7/14 29496
423	8999	Unrestricted Ending Fund Balance	\$514,340	(\$200,000)	\$314,340	XI-51	10/7/14 29496

CEQA

A CEQA Negative Declaration for the renovation of the SJEIC was adopted on December 1, 2009, File No. PP09-138.

By  _____
RICHARD DOYLE
City Attorney

By  _____
JENNIFER A. MAGUIRE
Interim Senior Deputy City
Manager/Budget Director

By _____ /s/ _____
BARRY NG
Interim Director of Public Works

cc: Norberto Dueñas, Interim City Manager

For questions please contact Glenn Schwarzbach, Sr. Deputy City Attorney at (408) 535-1900