

MEMORANDUM OF LAW

DATE: October 3, 1991

TO: Patricia Frazier, Director, Financial Management

FROM: City Attorney

SUBJECT: Phase Funding and Termination for Convenience Clause

BACKGROUND

By a memorandum dated September 6, 1991, you requested a brief discussion on the application of phase funding and the termination for convenience clause in major construction management and construction contracts for the Clean Water Program.

The concept of phased funding and the termination for convenience has been addressed in a memorandum of law dated January 16, 1991, written by Assistant City Attorney Curtis M. Fitzpatrick. Earlier memoranda, also authored by Mr. Fitzpatrick in January and March of 1990, address similar issues and provide this office's views concerning the applicability of Charter sections 80 and 99 to proposed major construction projects. I have attached copies of all three memoranda for your review as Enclosures 1, 2, and 3.

ANALYSIS

The genesis of phase funding and the termination for convenience clause as applied to the Clean Water Program was a proposal made by the City's financial consultants that major Clean Water Program contracts include terms which would:

- 1) provide for annual seriatim appropriations for the estimated cost of the construction, and
- 2) give a unilateral right to the City to terminate the contract in the event the City Council should, for whatever reason, choose not to appropriate monies to continue the contract.

Section 18 of Article XVI of the California Constitution provides in part:

No county, city . . . shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the qualified electors thereof, voting at an election to be held for that purpose . . . .

The intent expressed in the constitutional debt limitation was to limit and restrict the power of the municipality as to any indebtedness

or liability it has discretion to incur or not incur. *Compton Community College etc. Teachers v. Compton Community College Dist.*, 165 Cal. App. 3d 82, 90 (1985) citing *Lewis v. Widber*, 99 Cal. 412, 413 (1983).

Similar limitations are expressed in San Diego City Charter sections 80 and 99. In order to comply with the State Constitution and the two City Charter sections, the City of San Diego has traditionally funded contracts, both design and construction, for capital improvement projects on an appropriation basis. That is, at the time of contract award the total estimated funds required for the contract are authorized by the City Council. The traditional manner of appropriating a multi-year contract 'up-front' prompted the financial consultant's suggestion to consider phase funding multi-year or debt financed contracts. It was anticipated that major scheduled expenditures would dramatically impact sewer rates if the traditional appropriation basis were employed.

Phase funding allows the Clean Water Program to request Council authorization to fund contracts on a cash basis. Under phase funding, only those funds required for a specific phase of the entire contract will be authorized by the City Council. All subsequent phases will require additional Council action.

Appropriate 1472 language for phase funded contracts has been developed by Financial Management and concurred in by this office. Such language clearly identifies the total contract value, establishes the value of the phase for which appropriation is being requested, and delineates subsequent phases which are contingent upon Council approval. Enclosure 4, as attached is an example of appropriate 1472 language for phase funded contracts.

#### TERMINATION FOR CONVENIENCE

In order to implement the phase funding of contracts it was necessary to revise contract language to ensure that the City's rights would be protected. The termination for convenience clause was developed to ensure that protection.

Our earlier research, as discussed in a January 16, 1991, memorandum of law, indicated that a unilateral termination of convenience by the City "could be potentially construed by the courts in such a fashion as to allow the other contracting party to be relieved of some of its obligation to perform." Memorandum of Law, January 16, 1991, p. 2. The legal concept at issue is mutuality of obligation. Mutuality of obligation is necessary in bilateral contracts where there are mutual promises. "For the contract to bind either party, both must have assumed some legal obligations. Without this mutuality of obligation, the agreement lacks consideration and no enforceable contract has been created." *Mattei v. Hopper*, 51 Cal. 2d 119, 122 (1958). A termination for convenience clause, which clearly articulates the method by which a sum is to be determined and paid to the contractor should the City exercise the clause, was drafted and resolved our concern regarding mutuality of obligation. The City's termination for convenience is

limited to those instances where the City Council chooses not to appropriate sufficient funds for subsequent phases of work.

In addition to mutuality of obligation, we were concerned with another contractual concept, that of certainty. An offer must be sufficiently definite, or must call for such definite terms in the acceptance, that the performance promised is reasonably certain. 1 Witkin, Summary of Cal. Law, (9th ed. 1987) Contracts Section 145, p. 169.

In order to provide certainty and avoid ambiguities arising out of phase funded contracts, the scopes of work for the specific phases, the expenditures for those scopes of work, and the time within which that work is to be performed must be clearly articulated.

#### CONCLUSION

The phase funding of contracts and the termination for convenience clause are tools, which if properly implemented, provide continued compliance with State Constitution and City Charter provisions. While these tools assist in reducing the anticipated impact on sewer rates by such a large scale capital improvement program as that contemplated by the Clean Water Program, they do not completely alleviate the program's impact on sewer rates.

JOHN W. WITT, City Attorney

By

Marguerite S. Strand

Deputy City Attorney

MSS:skh:810(x043.2)

Attachments

ML-91-76

Mayor O'Connor and

Councilmember Roberts

- P-

September 25, 1991