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Modified Total Cost Method of Proving Damages: Approved For California Public Works

By Edward B. Lozowicki and Bram Hanono

Dillingham-Ray Wilson v. City of Los Angeles, 182 Cal.App.4th 1396 (opinion modified by 106 Cal.Rptr.3d 691, (April 16, 2010, No. B192900))

In *Dillingham-Ray Wilson v. City of Los Angeles*, the California Court of Appeal signaled its holding in the first sentence of its opinion: "The City of Los Angeles (City) obtained millions of dollars worth of construction work that it does not want to pay for." The City argued it was absolved of any obligation to pay the contractor, Dillingham-Ray Wilson (DRW), pursuant to Public Contracts Code sections 7105 and 7107 and *Amelco Electric v. City of Thousand Oaks* (2002) 27 Cal.4th 228 on the theory that they dictate a method of proving contract damages, a method DRW said was impossible under the circumstances. The Court disagreed because "section 7107 [sic] and *Amelco* impact the measure of damages, not the method of proving them . . . ." The Court also held that the modified total cost method of proving damages is permissible in California.

Background

The City awarded a contract to DRW to expand the digester capacity at the Hyperion Wastewater Treatment Plant. During construction, the City issued over 300 change orders containing more than 1,000 changes to plans and specifications. On rare occasions the City directed DRW to perform changes on a time and material basis, but as a general rule, the City requested an estimate of the cost of the work, told DRW to commence work, and agreed that the parties would negotiate a lump sum payment at a later date. Not all change orders were settled. When DRW completed the project, it requested an equitable adjustment to compensate it for expenses and losses incurred due to interference and delays by the City. The City refused and assessed liquidated damages against DRW. DRW sued for breach of contract, and the City cross-complained.

Before trial the City filed a motion *in limine* to prevent DRW from proving its damages with engineering estimates, based on Public Contracts Code section 7105(d)(2) (all further statutory references are to the Public Contracts Code). Section 7105(d)(2) states that the compensation due a public works contractor for amendments and modifications, such as change orders, can only be determined as provided in the contract. The trial court ruled the General Conditions of the contract (section 38(c) of the C-741 contract) required plaintiff to proceed on a time and materials basis and document actual costs if the parties failed to agree on a lump sum.

Based on *Amelco*, the City also filed a motion *in limine* to preclude DRW from presenting a total cost claim to the jury. The trial court agreed and precluded DRW from proceeding on a total cost theory of damages on the ground that DRW's evidence in support of that theory was insufficient, and held that a modified total cost theory was not recognized in California.

In response to the motions *in limine*, the trial court barred three of DRW's claims, including a claim for breach of implied warranty of correctness of plans. The jury found the City had breached the contract and caused DRW damages, and the City's assessment of liquidated damages was unreasonable.

Proof of Damages With Best Available Evidence Permitted

On appeal, the Court ruled that the *in limine* rulings be reversed. First, the Court held the trial court should have submitted the interpretation of the General Conditions section 38(c) of the contract to the jury. Since the terms of the contract were ambiguous as to the method to be used to document the cost of extra work, parole evidence was admissible to aid interpretation and DRW was entitled to a trial on the issue of contract interpretation.

Second, the Court held DRW was entitled to prove its damages with the best evidence available, even if that evidence takes the form of engineering estimates. Based on *Amelco*, DRW was precluded from recovering the reasonable value of its services based on a theory of abandonment, because the contract at issue was a public contract based on competitive bidding. Further, *Amelco* and section 7105 combined to prevent DRW from seeking to recover anything more for changes than it was entitled to receive by contract. Accordingly, the Court explained that "the benefit DRW would have received for change orders if the City had performed is the measure of damages." The Court concluded:

> Section 7105 impacts the measure of damages for public works contracts, but it does not impact the permissible method of proof. *In other words, an award of breach of contract damages under [common law] does not represent a contract modification barred by section 7105.*

This is a significant clarification of this statute which has been controversial in public works circles. In effect the Court was adopting the traditional "benefit of bargain" measure of damages

codified in California Civil Code §3300.

Breach of Implied Warranty of Correctness of Specifications Permitted Against Public Agency

The Court also held, pursuant to *Souza & McCue Constr. Co. v. Superior Court* (1962) 57 Cal.2d 508, that DRW was permitted to assert a claim for breach of the implied warranty of correctness of plans and specifications against the City. According to the Court, recovery based on a claim for breach of implied warranty of correctness would not "represent a contract abandonment barred by *Amelco*, nor would it represent a payment for an amendment barred by section 7107, subdivision (f)[sic]. Rather, it would simply represent an award for contract damages under longstanding common law."

Modified Total Cost Method of Proving Damages Permitted in California

Finally, the Court held that on remand DRW may pursue a modified total cost theory, if it is not required to document its actual costs. Under the total cost method, damages are determined by subtracting the contract amount from the total cost of performance. Under *Amelco*, the total cost method may be used only after the trial court determines the contractor has a *prima facie* case by showing the following: (1) it is impractical for the contractor to prove actual losses directly; (2) the contractor‘s bid was reasonable; (3) its actual costs were reasonable; and (4) it was not responsible for the added costs. If some of the contractor's costs were unreasonable or caused by its own errors, then those costs are subtracted to arrive at the modified total cost.

In its Order Modifying Opinion and Denying Petition for Rehearing, the Court held, "*Amelco* recognizes that a contractor can recover on a total cost or modified total cost theory." Therefore, the trial court abused its discretion by not following *Amelco*. "Section 7105 does not expressly abrogate common law, and the statute and common law can be harmonized because the total cost and modified total cost theories are merely methods of proving damages."

Conclusion

Dillingham significantly clarified *Amelco*, and breathed new life into the total cost and modified total cost methods of proving damages. Since *Amelco* was decided, common law contract damage principles as to public agencies have been under attack. Public agencies have argued with some success that *Amelco* insulated them from any form of damage proof other than daily costs tracked in the field, even where it was impossible to do so and could only be determined by engineering estimates or a modified total cost method at a later time. *Dillingham* holds that *Amelco* did not limit common law methods of proving damages against a public agency. Rather, it held only that the abandonment theory of liability is not allowed against a public agency.

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