

AGCC/LAC NEW CASES OF INTEREST

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No abandonment claims against public owners

Amelco Electric v. City of Thousand Oaks, 02 CDOS 1056 (2/4/02)

Reversed Court of Appeal judgment affirming trial court judgment for contractor on its abandonment claim against a public owner. On the contractor's breach of contract claim, remanded to Court of Appeal with instructions to remand to the trial court for retrial on the issue of damages.

This case arose from Amelco's contract to provide electrical work as part of the City of Thousand Oaks's construction of a Civic Arts Plaza. Amelco was awarded the contract after presenting the low bid at \$6.1 million. As the dissenting opinion noted, "it appears the City let the project out for bid before its plans were sufficiently complete to permit knowledgeable and informed bidding by building contractors, placed itself under an unreasonable time pressure by booking entertainment into the new facility without allowing a reasonable amount of time to complete the project, and then imposed numerous and substantial changes to the project while giving Amelco no extra time to complete the additional work." As a result, the City issued more than one thousand sketches to clarify or change the original contract drawings, nearly a quarter of which affected the electrical cost. The City agreed to only 31 of Amelco's 221 requested change orders, increasing the contract price by \$1 million. At the end of the project, Amelco filed a claim against the City that eventually totaled more than \$2 million for the additional uncompensated work, based on a theory that the City abandoned the original contract through its excessive change orders. The City denied Amelco's claim.

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1. Special thanks to my partners, Neil H. O'Donnell and Patricia A. Meagher, and associate, David F. Innis, for their assistance.

Amelco sued the City, alleging causes of action for breach of contract and abandonment. The trial court allowed Amelco to submit evidence of its damages under both theories using a modified total cost measure. Amelco prevailed against the City at trial, with the jury reaching a verdict in Amelco's favor on both of its causes of action and awarding Amelco damages under its modified total cost measure. The Court of Appeal affirmed, and the City appealed to the California Supreme Court.

Relying on the void contract rule, the Court holds that a contractor cannot recover against a public owner under the theory of abandonment. In other words, a contractor cannot claim that a public owner has made so many changes to a contract that it has abandoned the contract, such that the contractor should be paid in *quantum meruit* for the reasonable value of its services. Under the void contract rule, a contractor may not be paid anything for work performed under a contract that is subsequently declared void because the Government was not authorized to award the contract in the first place. In *Amelco*, the Court extends the application of this rule from problems that arise during the bidding of a contract to problems that arise during performance.

The majority opinion acknowledges that a contractor can seek recovery of its costs from a private owner under an abandonment theory under *C. Norman Peterson Co. v. Container Corporation of America*, 172 Cal. App. 3d 628 (1985), but holds that this theory cannot be applied in the public contracting context. The Court concludes that application of the theory in the public works context would render the concept of competitive bidding meaningless.

The opinion distinguishes between a contractor's right to bring an abandonment claim, which it rejects, and its right to bring a cardinal change claim, which it does not address. According to the Court, under an abandonment claim, the contractor is entitled to recover its total cost (less payments received) for work both before and after the contract was abandoned. In contrast, under a cardinal change claim, the contractor is only entitled to breach of contract damages for the additional work constituting a cardinal change. Although the Court does not reach the issue of whether a cardinal change claim would be viable in California, it is unclear under the Court's logic how a contractor could assert a cardinal change claim against a public owner without running afoul of the void contract rule, as applied by the majority opinion.

With regard to Amelco's submission of a modified total cost claim, the Court holds that Amelco did not submit sufficient evidence to warrant instructing the jury on that method of measuring damages. Calling this method "disfavored," the Court states that a contractor must establish four *prima facie* elements before it can proceed with a total cost claim: (1) the impracticality of proving its actual losses directly; (2) its bid was reasonable; (3) its actual costs were reasonable; and (4) it was not responsible for the added costs. The Court concludes that Amelco did not meet its burden of establishing the fourth element because it did not establish how any particular breach caused certain damages nor did it establish when any particular breach occurred. (Under this interpretation of the fourth

element, it would be difficult, if not impossible, for a contractor on a private project to ever recover under a total cost theory for an abandonment claim.)

Justice Werdegar, joined by Justice Kennard, provides a reasoned dissent. The dissent notes that a majority of jurisdictions allow abandonment claims and that, under the majority decision, California becomes the first jurisdiction to allow abandonment claims for private but not public projects. Contrary to the majority, the dissent opines that allowing abandonment claims for public projects benefits the public because it deters poor construction planning and management by public entities and because its absence will lead contractors to stop building where the public owner has imposed excessive changes, rather than continuing to work at the risk of never getting paid.

Comments: The decision gives new life to the void contract rule in California and pointedly extends it from problems which arise from the initial bidding of the contract to problems which arise during performance. That means that a contractor on a job which really goes bad and is very substantially changed may be facing the possibility of not being paid at all since the majority reasons that if the work is beyond the initial scope, it cannot be ordered without violating competitive bidding law.

Public owners can sue for punitive damages

City of Glendale v. Superior Court, 02 CDOS 1180 (2/6/02)

Reversed trial court's grant of motion to strike municipality's request for punitive damages.

Robert Fenton, an attorney, sued the City of Glendale for a contingency fee he was allegedly owed. The City cross-complained for fraud, seeking general, special, and punitive damages. Fenton moved to strike the City's request for punitive damages on the ground that a municipality is barred from recovering such damages. The trial court granted the motion, and the City appealed.

The Court of Appeal reversed, holding that a municipality may recover punitive damages to the same extent as a private party. The court reasoned that Civil Code § 3294 plainly states that a plaintiff, including a public entity, may recover punitive damages in appropriate cases. By so holding, the Second Appellate District departs from its prior decision in *City of Los Angeles v. Shpegel-Dimsey, Inc.*, 198 Cal. App. 3d 1009 (1988) and adopts the rule stated by the Fourth District in *City of Sanger v. Superior Court*, 8 Cal. App. 4th 444 (1992). In *City of Los Angeles*, the Second District held that allowing such recovery would raise serious questions of equal protection because public entities could recover punitive damages but not be liable for such damages. The court rejected that argument, noting that a rational basis exists for this asymmetry.

Hirer of independent contractor is not liable to contractor's employee for peculiar risk

under “negligent retention of control” theory absent affirmative exercise of control

Hooker v. Dept. of Transportation, 2002 DJDAR 1157 (1/31/02)

Reversed Court of Appeal’s reversal of trial court’s grant of summary judgment for defendant owner on plaintiff’s tort claim of negligent retention of control.

The plaintiff, Roseanne Hooker, was the widow of Paul Hooker, a crane operator for a general contractor hired by Caltrans to construct an overpass. During construction, Paul had retracted the outriggers on his crane to let traffic pass and was killed when he failed to re-extend the outriggers before swinging the boom, causing the crane to tip over and throw him to the pavement.

Roseanne sued Caltrans in tort for negligent retention of control, a specie of the peculiar risk doctrine found in the Restatement of Torts, § 414. Under the peculiar risk doctrine, a party that hires an independent contractor to perform inherently dangerous work may be liable if the contractor injures third parties in the course of that work. The trial court granted Caltrans’ motion for summary judgment on the ground that a hirer of an independent contractor is not liable to the contractor’s employees (as opposed to innocent bystanders) under that theory. The Court of Appeal reversed the summary judgment, and Caltrans appealed to the California Supreme Court.

The Supreme Court reversed the Court of Appeal, applying the reasoning in three prior Supreme Court cases regarding the peculiar risk doctrine: *Privette v. Superior Court*, 5 Cal. 4th 689 (1993) (failure to provide for special precautions – Rest. § 413); *Toland v. Sunland Housing Group, Inc.*, 18 Cal. 4th 253 (1998) (contractor’s negligent failure to implement special precautions – Rest. § 411), and *Camargo v. Tjaarda Dairy*, 25 Cal. 4th 1235 (2001) (negligent hiring – Rest. § 411). In each of those cases, the Court held that a contractor’s employee may not sue the hirer of the contractor under the peculiar risk doctrine.

The First Appellate District of the Court of Appeal had twice ruled on the issue of whether a contractor’s employee could sue the hirer of the contractor for negligent retention of control, with different results and each one taking an approach different from the absolute bar to suits in *Privette*, *Toland*, and *Camargo*. In *Grahn v. Tosco Corp.*, 58 Cal. App. 4th 1373 (1997), the First District held that a hirer will be liable to its contractor’s employee if it retains sufficient control to be able to prevent, through reasonable care, the dangerous condition causing injury. In contrast, in *Kinney v. CSB Construction, Inc.*, 87 Cal. App. 4th 28 (2001), the First District held that a hirer will only be liable to its contractor’s employee if it retains the ability to control safety **and** that retention of control affirmatively contributed to the employee’s injuries.

In *Hooker*, the Court adopted the approach in *Kinney*, holding that a hirer of an independent contractor is not liable to the contractor’s employee merely because the hirer retained control at the worksite, but that the hirer will be liable if its exercise of the retained

control affirmatively contributed to the employee's injury. Citing *Privette* and *Toland*, the Court reasoned that it would be unfair to hold a hirer liable merely due to its retention of control because that would subject the hirer to greater liability than the contractor who actually caused the injury but whose liability would be limited under worker's compensation laws. The Court also reasoned that it is fair to impose liability where the hirer's retention of control contributed to the injuries of a contractor's employee (as opposed to other peculiar risk torts for which the Court held there is no such liability) because the hirer's responsibility is direct, rather than merely vicarious or derivative.

In the case before it, Roseanne Hooker raised a triable issue as to whether Caltrans "actually exercised the retained control" at the worksite, but she failed to raise a triable issue as to whether that exercise "affirmatively contributed" to her husband's death. As a result, summary judgment for Caltrans was proper.

In her dissent, Justice Werdegar opines that a hirer should be liable to its contractor's employee if it negligently exercises control it retains over the safety of the work, regardless of whether the hirer's exercise of control affirmatively contributed to the employee's injuries. In effect, the dissent would adopt the rule in *Grahn*. According to the dissent, requiring affirmative contribution is contrary to California's system of comparative fault. The jury should be allowed to weigh each party's involvement and apportion fault, presumably finding an actively negligent contractor more responsible than a passively negligent hirer in most cases.

Hirer of independent contractor is liable to contractor's employee for peculiar risk under "negligent provision of unsafe equipment" theory

McKown v. Wal-Mart Stores, Inc., 02 CDOS 947, 2002 DJDAR 1164 (1/31/02)

Affirmed Court of Appeal decision affirming trial court's judgment for plaintiff on his tort claim for negligent provision of unsafe equipment.

In the companion case to *Hooker*, the Court holds that a hirer of an independent contractor is liable for the injuries of the contractor's employee where the hirer provided unsafe equipment which affirmatively contributed to those injuries.

McKown was an employee of a contractor hired by Wal-Mart to install sound systems in its stores. Wal-Mart requested that the contractor use Wal-Mart's forklift for the work. The forklift Wal-Mart provided was defective in that the work platform was not chained to the forklift or extension. McKown was working on the platform when it disengaged from the forklift and, as a result of its defect, fell off the forklift, dropping about 12 to 15 feet and injuring McKown.

McKown sued Wal-Mart for negligent provision of unsafe equipment. At trial, the jury entered a verdict for McKown, and the Court of Appeal affirmed. The Supreme

Court again affirmed. It reasoned that where a hirer of contractor provides negligent equipment that contributes to injuries suffered by an employee of the hired contractor, the hirer's liability is more direct than vicarious or derivative. Thus, McKown's claim is more like that in *Hooker*, where the Court stated it would impose liability for a hirer who retains control of a portion of the work and thereby affirmatively contributes to such injuries, than in *Privette, Toland, and Camargo*, where the Court stated a hirer can never be liable for failure to provide for special precautions, contractor's negligent failure to implement special precautions, and negligent hiring, respectively.

Again, Justice Werdegar dissents, opining that a hirer should be liable to its contractor's employee if it negligently provides unsafe equipment that contributes to the employee's injuries, regardless of whether the hirer's actions "affirmatively" contributed to those injuries.

Anti-SLAPP statute does not provide grounds for striking cross-complaint for False Claims and other causes of action

Kajima Engineering and Construction, Inc. v. City of Los Angeles, 02 CDOS 950 (1/30/02).

Affirmed trial court's order denying plaintiff's motion to strike cross-complaint under anti-SLAPP statute.

In *Kajima*, the contractor, Kajima, sued the City of Los Angeles for payment it claimed was owed for work at the Port of Los Angeles. Kajima's complaint sought approximately \$35 million in damages. The City filed a cross-complaint alleging breach of contract and later amended it to include 19 additional causes of action, among them 10 causes of action based on violations of the California False Claims Act. The amended cross-complaint sought \$400 million in damages. It included allegations that Kajima intentionally underbid the project knowing it could not complete the work within the price submitted, claimed additional compensation based on false or inflated progress payment requests, improperly identified subcontractors that would work on the project, and falsely certified women and minority business enterprises participation on the job.

Under California's anti-SLAPP statute (C.C.P. § 425.16), a cross-complaint or independent lawsuit that is filed to prevent a citizen from exercising the constitutional right to speak and petition the government for redress of grievances (known as a strategic lawsuit against public participation or SLAPP suit) is subject to a special motion to strike. Kajima moved to strike the amended cross-complaint as a SLAPP suit, alleging that the City's cross-complaint arose from, and was in retaliation for, Kajima exercise of its constitutional right to petition the court for redress by filing its complaint in this action. The trial court initially agreed and struck the amended cross-complaint but, on reconsideration, ruled that only the twelfth cause of action, which specifically mentioned Kajima's filing of the complaint, should be stricken.

Kajima appealed, contending that the trial court erred in striking only the twelfth cause of action. The Court of Appeal disagreed, finding that the amended cross-complaint alleges causes of action arising from Kajima's bidding and contracting practices, not from acts in furtherance of its right of petition or free speech. Kajima also argued that the cross-complaint should be dismissed because the City was guilty of "oppressive litigation tactics." The Court of Appeals rejected this argument, noting that the City's cross-complaint arose out of the same transaction as Kajima's underlying complaint -- the bidding, contracting and construction of the Port project -- and not out of the litigation process itself.

In *dicta*, the court suggests that a plaintiff is not defenseless against cross-complaints filed for an improper purpose, *i.e.*, to harass, to cause unnecessary delay, or to needlessly increase the cost of litigation. The cross-complaint may still be attacked under C.C.P. § 128.7 if it is truly frivolous.

Comment: This decision basically eliminates the anti-SLAPP statute as a means of dismissing frivolous False Claims cross-complaints. The only exception is where a public entity cross-complains claiming the submission of a complaint, or some similar document (a bid protest or other administrative complaint should suffice), is itself a false claim. But even in that case, the public entity can withstand a C.C.P. § 425.16 motion to strike if it can show that there is a probability it will prevail on its cross-complaint.

Court may not order party to pay for discovery (e.g., destructive testing) it did not request

San Diego Unified Port Dist. v. Douglas E. Barnhart, Inc., 02 CDOS 1328 (2/7/02)

Reversed trial court's order directing two co-defendants to share in cost of destructive testing requested by other co-defendants.

Douglas E. Barnhart, Inc. and SGPA Architecture were the prime contractor and primary designer on a project for the construction of a new terminal at the San Diego International Airport for the San Diego Unified Port District. The District sued Barnhart and SGPA and others for alleged construction defects in various portions of the project, including stone tile flooring. Three of the other co-defendants in the action requested destructive testing of the stone floor, and they requested that Barnhart and SGPA share in the cost of that testing. Concluding that Barnhart and SGPA were involved with the stone tile allegations in the District's complaint, the special master recommended that they be required to share in the cost of the testing. The court entered an order adopting the special master's recommendation. Barnhart and SGPA appealed.

The Court of Appeal reversed, holding that the trial court exceeded its authority and that its order was an abuse of discretion. "No California statute authorizes a trial court to order litigants before trial to pay for destructive testing or any other discovery they do not wish to pursue." The court's inherent power to exercise reasonable control over

discovery matters did not authorize its order.

Good faith interpretation of contract requirements negates scienter requirement under Federal False Claims Act

United States ex rel. Quirk v. Madonna Towers, Inc., 2002 U.S. App. LEXIS 1647 (8th Cir. 2/4/02)

Affirmed summary judgment for defendant on *qui tam* relator's claims under the Federal False Claims Act (FCA).

In *Quirk*, the relator, the nephew of a patient-resident at the defendants' skilled nursing facility, claimed that the defendants submitted claims for Medicare reimbursement from the Government for payments that the patients themselves were not obligated to pay. Defendants offered evidence that the patients were in fact obligated to pay for the reimbursed services and that defendants were simply following standard practices in the industry. The relator's main argument was that the defendants knowingly submitted false claims because they failed to seek a legal opinion to support their theory before they submitted their claims. Defendants successfully moved for summary judgment, and the relator appealed.

The Eighth Circuit affirmed. It responded to relator's arguments, stating that "failing to secure a legal opinion, without more, is not the type of deliberate ignorance that can form the basis for a FCA lawsuit. [Defendants' employees'] declarations and depositions make it clear that neither of them had any reason to pursue a legal opinion concerning the billing practices because both of them considered the practice acceptable standard procedure." As such, the relator failed to raise a triable issue as to whether defendants had the requisite scienter for liability under the FCA.

The Eighth Circuit clearly intended *Quirk* to serve as a counterpoint to the Ninth Circuit's decision in *United States ex rel. Oliver v. Parsons Co.*, 195 F.3d 457 (9th Cir. 1999), which held that a good faith interpretation of a contract provision cannot disprove the element of falsity. It cited *Oliver* for the proposition that "innocent mistakes and negligence are not offenses under the Act." And it concluded its analysis with the following footnote: "This does not mean that [defendants' employee's] understanding of the [contract] was legally correct. We are not deciding the issue of whether the submitted claims were in fact false or fraudulent. Our decision today is simply that Madonna Towers did not knowingly submit false or fraudulent claims."

Comment: According to *Oliver*, only a court can decide the "truth" of a contract provision. *Oliver*, which has generally been followed by other circuits, has forced False Claims Act defendants to use the good faith interpretation of the contract to disprove scienter, in other words, to use the defendant's understanding of the contract to show that the defendant did not knowingly submit a false claim. It has been generally felt, however, that such a strategy would be unlikely to succeed on a summary judgment motion. *Quirk* proves

that a defendant can win such a motion. *Quirk* provides the strongest precedent to date upholding a defendant's summary judgment motion based on a theory that a good faith interpretation of a contract disproved scienter. The Justice Department recognized the potential significance of this ruling: it took the relatively unusual — and ultimately unsuccessful — step of intervening on appeal.

An insured's judgment creditor is not a third party beneficiary for purposes of recovering its attorneys' fees from the insured's liability insurer

San Diego Housing Commission v. Industrial Indemnity, 02 CDOS 774 (1/28/02)

The San Diego Housing Commission contracted with general contractor John B. Reed Construction Co. (JBR) for the construction of a low income housing project. The contract included a clause entitling the prevailing party in any dispute to recover its attorneys' fees and costs. The Commission sued JBR for construction defects. JBR tendered the complaint to its liability insurer, Industrial Indemnity Co. (IIC), which denied any coverage or duty to defend. The Commission obtained a default judgment against JBR for all damages sought, including the Commission's attorneys' fees and costs.

The Commission then sued IIC under Ins. Code § 11580(b)(2) to recover the amount of its default judgment against JBR. The Commission contended that it was entitled to recover its attorneys' fees and costs from IIC under JBR's liability policy. That policy included a supplementary payments provision (SPP), which stated that the insurer would pay, in addition to policy limit of liability, "all costs taxed against the insured in any suit defended by [IIC]." IIC argued that it was not liable to the Commission under the SPP because it had not defended JBR in the underlying lawsuit. At trial, the jury found that IIC had a duty to defend JBR in the Commission's action against JBR, and the court found that IIC could not rely on its breach of that duty as a ground for avoiding liability under the SPP. Concluding that the Commission was an intended third party beneficiary under JBR's policy with IIC, the trial court concluded that the Commission was entitled to recover its fees and costs from IIC under that policy. IIC appealed.

The Court of Appeal reversed, holding that the Commission was not entitled to recover from IIC because it was not an intended third party beneficiary under JBR's policy. The court reasons that the SPP obligation clearly arises out of the duty to defend, which is a covenant in the policy that only runs to the insured. "[T]hird party beneficiary rules in the insurance context suggest that [Ins. Code § 11580(b)(2)] creates a third party beneficiary relationship between the insurer and the judgment creditor, but only as to those policy terms that inure directly to the benefit of a judgment creditor."

By relying on its conclusion that a judgment creditor is at most an incidental beneficiary of an insurer's duty to defend its insured, the court avoids answering the question of whether the fact that IIC did not in fact defend its insured precludes application of its SPP obligations.

Comment: It is unclear whether the result would have been different in this case had the Commission been an additional insured named in JBR's policy. While that would clearly have made the Commission an intended beneficiary under the policy, there would still be the question of how IIC's failure to defend would affect application of the SPP.