



The Legis Report

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Damages

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DAMAGES IN GENERAL

The ideal end sought by the claimant in a contract dispute is to prevail – but to prevail in two equally important ways. First, the claimant, Party One, must succeed in convincing the trier-of-fact (judge, jury or arbitrator) that (a) Party Two failed to live up to its obligations under the contract, (b) those failures were material, and (c) those failures resulted in Party One incurring some real loss or damage. Second, Party One must present to the trier-of-fact a calculation of these damages and show a clear connection between Party Two's failures and the damages sought. Absent both of these, Party One will likely not fully prevail.

There have been situations where Party One convinced the trier-of-fact that it had been damaged but failed to satisfy the trier-of-fact as to the amount of the damages. The result was that the trier-of-fact found against Party Two and required Party Two to pay only minimal damages – clearly not a satisfactory outcome for Party One.

In a law suit, the calculation of damages is always a challenge. In most situations arising out of contract disputes, one or more of the parties will ask for a monetary award. The nexus between the failures of the other party and the cost incurred is often referred to as 'damage causation' or 'damage linkage'.

It is important to understand what constitutes Damages. Damages are of two types, 'Direct Damages' and 'Consequential Damages'.

Direct Damages – 'Direct Damages' are those damages which are directly attributable to a specific event. For example, a utility contractor uncovers an electric vault during pipe excavation operations. The owner knew the vault was there but failed to communicate that fact to the contractor. As a result, the contractor had to dismantle a length of previously laid pipe and re-lay the pipe to avoid the vault. The costs incurred by the contractor relocating of the pipe would be deemed 'Direct Damages'. These would include the cost of the crew,

equipment and material that might be required. 'Direct Damages' also includes supervision, extended jobsite overhead, home office overhead, engineering, storage, and related costs.

It is important to note that 'Direct Damages' in the legal sense differ from 'Direct Costs' in the accounting or cost management sense. Viewed from the legal perspective, 'Direct Damages' includes all attributable direct costs, indirect costs and, in some circumstances, profit. Therefore, one can see that 'Direct Damages' is not the same as 'Direct Costs'.

Consequential Damages – 'Consequential Damages' include damages that do not flow directly from the event but rather are the consequences of the event. Examples of consequential damages include interest of the contractor's capital investment and lost profits if the contractor was not able to bid additional work until the claim was resolved because of limitations imposed by the contractor's bonding company.

There are various ways to calculate or determine damages. These methods include: (a) Total Cost Method, (b) Modified Total Cost Method, (c) Jury Verdict Method, (d) Discrete Cost Method, and (e) Quantum Meruit Method.

Total Cost Method – The Total Cost Method is a simplistic approach to damage calculation. It presents the total cost of the work incurred by the claimant and then subtracts the estimated cost of the work (the claimant's estimate used to develop the claimant's bid). The net is identified as the damages. This approach assumes that the claimant's cost are reasonable, that there were no errors in the claimant's estimate, that all the responsibility for the overage was the result of the other party's actions, and that the claimant made no errors in execution of any of the project's work activities that resulted in increased cost. Under this approach no linkage is demonstrated between the impacting event(s) and the damage calculation.

Over time, courts have hesitated in awarding damages under the Total Cost Method. Therefore, the construction claims community has developed a method that eliminates some, but not all, of the weaknesses of the Total Cost Method.

Modified Total Cost Method – The Modified Total Cost Method improves on the Total Cost Method by adjusting the calculation in an attempt to eliminate the difficulties with the Total Cost Method. First, the calculation is reduced to reflect any errors in the original estimate. Second, the calculation is also reduced to reflect those costs which were the responsibility of the claimant. Third, the costs resulting from the actions of any third parties are deducted. Last, the calculation is reduced to reflect any inefficiencies on the claimant's part in any of the work activities. The Modified Total Cost Method offers a more reasonable damage calculation but still does not link the impacting event(s) and the damage calculation.

Jury Verdict Method – The Jury Verdict Method is used when the claimant has incurred actual damages but there is no way to reasonably calculate those damages. Under this method, the determination of the amount is left to the trier-of-fact (judge, arbitrator or jury).

Discrete Cost Method – The Discrete Cost Method relates the damage calculation directly to the various impacting events. One of the best ways is for the claimant to keep separate accounts for the additional costs rather than to lump the impacted work's costs in with the costs of the original work. This requires the use of a fairly detailed cost accounting system typically employing codes for the various work items covering labor, equipment and material charges. Other ways to identify discrete costs are to use costs from published cost manuals adjusted for the location of the work, comparison of impacted costs versus un-impacted costs, etc.

The Discrete Cost Method is the approach most universally accepted by triers-of-fact. It generally requires more effort to prepare and often results in a lesser amount of damages, but these are more than offset by its acceptance by courts. The reason it has such universal acceptance by the courts is that it allows for the establishment of 'damage causation' or 'damage linkage'. In effect, it allows the reasoning developed in the legal argument to continue through the damage calculation – resulting in a more consistent, comprehensive narrative of what happened, why it happened and, finally, the economic impact.

Quantum Meruit Method – The Quantum Meruit

Method is much like the Total Cost Method but is usually applied to a situation where the impacting event(s) so grossly change the project that the work is completely different than the work originally bid. This condition is sometimes referred to as a 'Cardinal Change'. To understand what it takes to have a cardinal change (and use a Quantum Meruit damage calculation) it may be useful to relate an example offered by a distinguished construction claims attorney during a seminar attended by the author many years ago. The attorney said that if a contractor had been awarded a contract for the construction of a factory and after beginning work was issued a unilateral change order adding a railroad spur to the factory – that would be a Normal Change. If the same contractor had been awarded a contract to build a railroad spur and after beginning work was issued a unilateral change order adding a factory to the end of the railroad spur – that might be a Cardinal Change. The basis of Quantum Meruit is the 'value of the work'. It is usually only applied in extraordinary cases when no other method is available to calculate the damages and the total value of the work is key to the legal arguments.

DAMAGE CALCULATIONS

The very term 'Damage Calculations' might seem to imply just a set of calculations. This is often an appealing concept to an accountant or an engineer. But in terms of Damages as a part of a lawsuit arising out of a contract dispute, it is far more than just a set of numbers. It is in-fact, an argument or a persuasive presentation, the objective of which is to convince the reader of the merit, accuracy and reasonableness of the sum or sums being sought by the claimant. That said, it is hard to develop such an argument solely with numbers on a spread sheet or a stack of invoices accompanied by an adding machine tape.

A key part of the damage calculation is the supporting narrative. The legal argument generally establishes the facts and the legal theory for recovery. It generally enumerates the various items for which the claimant should be compensated. What it does not do is link an invoice for 15.2 tons of crushed aggregate to the bedding for relocated pipe in the afore-mentioned utility contractor's claim for compensation for avoiding the electric utility vault. It may be necessary to explain in the narrative that invoices for lumber and plywood cover materials required to fabricate formwork for a concrete junction box which was necessary for the relocation of the pipe.

The damage calculation is generally presented in a logical manner, usually beginning with the direct costs

(labor, equipment, materials and outside services), then addressing indirect cost, and finally profit, if appropriate.

Labor – Labor is always an interesting element of damages. Because the cost of a labor hour has numerous components, it may be useful to present a ‘build-up’ of labor work-hours by craft by year. Beginning with the direct wage, add the statutory taxes, workmen’s compensation charges and the like to arrive at a burdened labor rate for each labor category by year. Because the term ‘burdened labor rate’ can imply different types of burden, the simplest is described above. A ‘fully burdened’ labor rate may also include an allocation of overhead and even profit. Whichever approach is taken, be consistent and avoid ‘double dipping’ [double dipping in this context is using a fully burdened labor rate and later applying an overhead percentage that represents a portion of the same indirect cost].

Equipment – The equipment component of damages presents its own set of challenges. Outside rental equipment is generally straight forward. The invoice represents the cost of the equipment for the stated period – day, week or month. But take cognizance of whether the equipment is dealer maintained or is a bare rental. If it is a bare rental and the equipment was used over an extended period, the claimant probably incurred maintenance cost (mechanic time, parts, fuel, lubricants, filters, etc.) against the operation of the equipment, which would not be reflected in the equipment dealers invoice.

Company-owned equipment has its own issues. If the claimant utilizes an equipment account (it charges each job an hourly or daily rate for company owned equipment), it is important to know whether the equipment account is a ‘break-even account’ or a ‘profit center’. If it is a ‘break-even account’, the equipment rates can generally be used, assuming that there is no duplication of indirect charges. If it is a ‘profit center’, elements of indirect charges and profit included in the rates must be adjusted for.

If the claimant owns the equipment but does not charge its use to the project, its value to the project must be considered. There are various equipment rental rate publications that can be used. Again, it is important that the publication be consulted to determine if the rates include indirect cost, maintenance and profit. In addition, if the piece of equipment was used for more than a month, the monthly rate, not the daily rate should be used. If a rental rate publication is used, be sure that the appropriate equipment attachments such as buckets, booms, etc., are included if they have

separate rates.

Materials – Individual material invoices should relate to the materials used in the disputed work. When materials are pulled from stockpile, the use of average pricing is generally appropriate. If material quantities are developed from takeoff, consideration should be made for waste and over-break.

Outside Services – Outside services are generally priced based on vendor invoice. As with materials, the narrative should identify what the service was used for and why.

Site Overhead – If the claim involves delay, the site overhead damage component is generally a time sensitive element. One-time costs would not generally be included. Other costs (including supervision, job office staff, field engineering, vehicles, material handling equipment, utilities, and security to list only a few) have the potential to be included in site overhead.

Corporate Overhead – The cost of corporate overhead is an appropriate component of a damage calculation. There are various methods to arrive at that value. Some of these methods are somewhat complicated and, as such, are beyond the scope of this paper.

Profit – State statute and contract provisions will often determine if profit is a part of damages.

ADDITIONAL CONSIDERATIONS

Organization of the damages section is an important factor. A persuasive presentation should be a clear presentation. It should avoid ambiguity. In short, it should be an easy to read and understand.

It is important to remember that while we are developing the damage calculations to be presented at trial, at any time the parties may enter into settlement negotiations. Here too, organization and clarity are of great importance. If the claimant wants the other party to write a check for the damages, the claimant should make it easy for the other party to understand what the check is for. During negotiations, the claimant will likely be asked to explain in exhaustive detail how the damages were calculated. We must keep in mind that the goal is to get paid, preferably by negotiation but if necessary by judgment.

Recently a contractor brought a claim against an owner for \$12 million. The damage calculation lacked a cohesive damage narrative but included notes on the calculation spreadsheet that gave the reader a general sense of what was being asked for. The damage calculation also included an appendix which consisted of four years of cost reports – about three inches thick. When

the individual items listed on the spreadsheet were checked against the cost reports, the claimed cost either equaled the amount carried on the cost report or, on numerous occasions, was less than the amount shown on the cost reports. What appeared unusual was the fact that the claimed amount was never more than the amount shown on the cost report for any claimed item. When the preparer was questioned about this anomaly, she stated that she had reduced the claimed amount for some of the items for various reasons: (a) the owner was only partially responsible for the charge; (b) the charge covered a longer time period than the impacting event; or (c) a portion of the cost was duplicated elsewhere. These were all valid reasons for adjusting the claimed amount down but since the claim was based on the cost report data, there was a loss of confidence that the costs were transferred correctly and appropriately to the spreadsheet. The narrative should have addressed each of these anomalies describing why the reduction was taken, making it easy for the reviewer to understand the amount being asked for and why it differed from the cost report values.

In the same claim, the spreadsheet headings and descriptions often differed from those on the cost report. They were close, but it took some effort to be sure that the claimed item was the same as the cost report item. The spreadsheet items should have had a note that referred the reader to the page number and line number on the cost report to allow for an efficient review. Again, make it easy for the other party to write the check.

There is another reason for preparing detailed damage calculations in support of a contract dispute. Very many, if not the majority, of such disputes are settled before going to trial. Many organizations, particularly governmental agencies, require the damages arrived at through negotiation be documented internally to a very detailed level. If the claimant brings a well prepared damage calculation to the negotiation table, the agency will use these calculations to justify the amount of the settlement. This approach may result in a larger and quicker recovery for the claimant because it was easy for the agency to document.

CONCLUSION

Damage calculations, properly prepared, are vital to the success of any contract dispute. They make the claim easier to present, defend, and negotiate or try. Damages are secondary to the legal arguments of entitlement, but once entitlement is established, recovery of damages in the proper amount and received in a timely manner should be the main focus.

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Wilshusen, D., Fred et.al. *Fundamentals of Construction Law*. Chicago: American Bar Association, 2001.
Cushman, Robert. *Proving and Pricing Construction Claims*. Gaithersburg: Aspen Law & Business, 2001.

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Legis Awarded GSA MOBIS Contract

Recently, Legis Consultancy was awarded a Mission Oriented Business Integrated Services ("MOBIS") Contract by the US General Services Administration ("GSA"). This contract allows all federal government agencies to engage Legis Consultancy for consulting services in the areas of Litigation Consulting, Cost Engineering and Management Consulting. The MOBIS contract is awarded to firms "who possess the necessary expertise" to assist the federal government in a variety of service areas.

Michael Ray Elected Fellow

The Association for the Advancement of Cost Engineering ("AACE International") elected Michael Ray a fellow at its recent annual meeting. Mike, the Managing Principal at Legis, has been a member of AACE International for over 20 years and carries multiple organization certifications. He has been elected to the Association's international board of directors and served as the co-chair of the committee which established the Planning and Scheduling Professional ("PSP") Certification.



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