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**“THE TOTAL COST METHOD:
AN ALTERNATIVE THEORY FOR PROVING DAMAGES”**

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THE TOTAL COST METHOD: AN ALTERNATIVE THEORY FOR PROVING DAMAGES

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I. INTRODUCTION

In construction litigation, claimants are increasingly seeking more exotic species of damages such as those flowing from constructive acceleration and other "impacts" to their work. Proof of direct causation between an act or omission, and the damages purportedly suffered is often tenuous or entirely incapable of proof. To overcome this impediment, contractors are turning with greater frequency to the "total cost method" of proving these damages. This has proved to be a double-edged sword for sureties who, in one case, must defend against the blows of a contractor's claim which is using this method of proof, but may at the same time in a separate case wish to use the total cost method when pursuing a claim on behalf of an insolvent principal.

Under the total cost method, damages are measured by comparing the claimant's actual cost of performance with its pre-bid estimates. This method does not attempt to make a causal connection between claimant's damages and defendant's actions. Instead, it assumes that all costs incurred in excess of the bid were caused by the defendant. The total cost method is based on the assumption that, if not for the defendant, then the claimant would have been able to complete the project on-time and within budget. Courts have traditionally been reluctant to use the total cost method because it is based on this assumption and not on actual events. This is particularly true in complex construction disputes, where both owner and claimant are often responsible for a project's delays and disruptions.

The courts must reconcile competing interests. While courts will not prevent a claimant from recovering for a delay or disruption merely because the claimant cannot precisely quantify its actual damages, they will not give the claimant a windfall by allowing it to shift all of its overruns to the owner. Courts that have recognized the total cost method have done so reluctantly. In WRB Corp. v. United States, 183 Ct. Cl. 409, 426 (1968), considered to be the benchmark case on the total cost method, the court stated the total cost method "has never been favored by the court and has been tolerated only when no other mode was available and when the reliability of supporting evidence was fully substantiated. The total cost method, although frequently asserted by contractors, should only be used under exceptional circumstances." This paper will address the criteria a plaintiff must establish to recover under the total cost method and how courts have applied and modified this method to reconcile the competing interests of owner and claimant.

II. TOTAL COST METHOD

In its simplest form, the total cost method allows a claimant to establish damages by calculating the difference between its actual costs of performance, plus profit, and the contract price/bid amount. This method is very helpful to contractors because in complex construction matters it is often difficult to quantify the actual damages resulting from a delay or disruption.

The United States Court of Claims has established four criteria that a claimant must satisfy before it can use the total cost method:

1. The nature of the additional costs was such that there is no other practicable means of measuring damages;
2. The plaintiff's bid or estimate was realistic;
3. The plaintiff's costs were reasonable;
4. The plaintiff was not responsible for any of the additional expense.

See WRB Corp. v. United States, 183 Ct. C1. 409, 426 (1968); J.D. Hedin Construction Co. v. United States, 347 F.2d 235 (Ct. C1. 1965). These four criteria have been adopted by other jurisdictions, including Florida, that have recognized the total cost method. See e.g., McDevitt & Street Co. v. Department of General Services, 377 So.2d 191, 192 (Fla. 1st DCA 1979) (Court relies on "federal government" breach of contract cases in applying total cost method.)¹

In McDevitt, for example, a general contractor asserted a total cost claim for delay damages caused by an architect's errors and omissions. The contractor claimed that it was entitled to the difference between its original budget for labor costs, plus the amounts received in change orders for specific extra work, and its actual labor costs expended as a result of the delay.² The hearing officer held that the owner was liable for the delay, but only awarded the contractor's average daily cost times the number of days the project was delayed. The hearing officer held that the direct labor component of the contractor's claim was covered by previous change orders, "which had extended the project time and the contract sum." The contractor appealed, claiming that it was entitled to the total amount it expended over and above the sum of its contract price and the amounts it received in change orders.

The District Court of Appeals reversed and remanded the case to the hearing officer to determine if the contractor had satisfied the four total cost method criteria. In explaining the total cost method, the McDevitt Court quoted from the Court of Claims' opinion in J.D. Hedin Construction:

The exact amount of additional work which plaintiff had to perform as a result of the foundation problem is difficult, if not impossible, to determine because of the nature of the corrective work which was being performed . . . There is no precise formula by which these additional costs can be computed and segregated from those costs which plaintiff would have incurred if there had been no government-caused difficulties. However, the reasonableness and accuracy of plaintiff's estimate, which was prepared by an experienced engineer whose qualifications have been unchallenged, have been

¹ There are only two reported Florida decisions that have used the total cost method for establishing damages in construction cases. See McDevitt, 377 So. 2d 191; Department of Transp. v. Hawkins Bridge Co., 457 So.2d 525 (Fla. 1st DCA 1979). Similarly, there are few reported decisions applying the total cost method in Alabama, Georgia and Tennessee.

² In determining "actual costs" under the total cost method, claimants will often include indirect costs from change orders received or asserted during the Project. Thus, an owner that receives multiple change orders during a project probably should expect a delay or disruption claim under which the contractor will attempt to recover all of its total costs.

established. Defense counsel stated that the estimate was not challenged. The closeness of the bids gives support to reasonableness of the estimate. The bidders were three extremely experienced contractors of large construction projects. Plaintiff on prior occasions had successfully constructed a number of large projects for the Veterans Administration. Plaintiff has established the fact that it performed additional work. Moreover, the responsibility of defendant for these damages is clear.

Id., quoting. J.D. Hedin Construction, 347 F. 2d at 247. Similarly, in Hawkins Bridge, 457 So.2d 525, the District Court of Appeal refused to overturn the trial court's application of the total cost method because there was evidence that the four criteria had been met³.

The claimant must meet a very heavy burden of proof to establish these four criteria. Boyajian v. United States, 423 F.2d 1231, 1243 (Ct. C1. 1970); See also, S.W. Electronics & Manufacturing Corp. v. United States, 655 F.2d 1078 (Ct. C1. 1981); United States v. R.M. Wells Co., 497 F.Supp. 541 (S.D. Ga. 1980). There is no presumption of reasonableness as to the plaintiffs' original estimate or actual costs. Boyajian, 423 F.2d at 1243 (citations omitted). In WRB Corp., the Court of Claims explained that the total cost method "has never been favored by the court and has been tolerated only when no other mode was available and when the reliability of supporting evidence was fully substantiated." 183 Ct. C1 at 426 (emphasis added); See also, Boyajian, 423 F.2d at 1243.

a. No other practicable means of measuring damages

The first criterion for using the total cost method is that there are no other practicable means of measuring damages. The claimant must prove that its additional costs (resulting from the owner's actions) cannot be measured with any reasonable accuracy. J.D. Hedin, 347 F.2d at 235. In J.D. Hedin, for example, the court found that the exact amount of additional work the plaintiff had to perform was difficult, if not impossible, to determine. The court noted that the plaintiff had established that there was no precise formula by which its additional costs could be "computed and segregated" from those costs which it would have incurred if there had been no government-caused difficulties. Id.

A claimant can also meet this criterion by demonstrating that the defendant caused so many delays, disruptions or other changes that it was impossible to quantify the damages for each particular act. See e.g., In re Meyertech Corp., 831 F.2d 410 (3rd Cir. 1987); E.C. Ernst, Inc. v. Koppers Co., Inc., 626 F.2d 324, 327 (3rd Cir. 1987). Courts have reasoned that it is impractical for a claimant to maintain detailed cost records to measure the precise impact of such changes.

However, a claimant will not satisfy this criterion by simply failing to maintain adequate records. See e.g., Boyajian, 423 F.2d at 1235. In Boyajian, the court held that the contractor's failure to record its increased costs did not necessarily mean that there was no other method for calculating damages. Id. The court recognized that it is unusual for contractors to keep detailed costs records of these impacts. "Such failure, however, normally does not prevent the submission of reasonably satisfactory proof of increased costs incurred during certain contract periods or flowing from certain events based, for instance, on acceptable cost allocation principles or on expert

³ The Court also approved the trial court's submission of alternative damage theories to the jury. Id. at 528. See also, Nebraska Pub. Power Dist. v. Austin Power, Inc., 773 F.2d 960 (8th Cir. 1985) (actual costs, total cost and modified cost methods submitted to jury).

testimony." Id. In short, a contractor must attempt to make a causal connection between the defendant's breach and its damages or explain why such an attempt was not made or why it would not have produced reasonably accurate results. Id. at 1235.

b. The original bid or estimate was realistic

The second criterion for using the total cost method is to establish that the claimant's bid or estimate is realistic. To satisfy this criterion, courts have typically required a claimant to show that it was diligent in preparing its bid and that the bid was within the range of other bids submitted for the project. See McDevitt, 377 So.2d at 193, citing J.D. Hedin, 347 F.2d at 247. In determining that a claimant's bid was reasonable, these courts relied on testimony concerning the bidders' qualifications, the plaintiff's estimates for other similar projects and the methods used and information relied on in preparing the bid. Id. Industry estimating manuals and comparisons of supplier and subcontractor quotes with bid amounts and material quantity estimates can also be used to support this testimony. It is important to note, however, that this type of an analysis is very expensive and time consuming; it is also easily refutable because, like the total cost method, it relies on assumptions, which claimants make during the bidding process. Construction Litigation: Strategy and Techniques, §7.8 at 152.⁴

c. Actual costs were reasonable

The third criterion for using the total cost method is that the claimant's actual costs were reasonable. The reasonableness of a claimant's actual costs generally is the easiest of the criteria to establish. Courts typically require a contractor to demonstrate that it acted reasonably in incurring its additional costs. Contractors generally will attempt to satisfy this requirement through the use of expert testimony and reliance on industry standards. See e.g. McDevitt, 377 So.2d at 193 (expenditures on prior successful projects accepted as evidence as reasonableness of actual costs). A contractor can also satisfy this criterion by demonstrating that it took measures to mitigate its additional costs.

d. The contractor was not responsible for added expenses

The final, and most difficult criterion for using the total cost method is that the claimant was not responsible for the additional costs incurred. This criterion is based on the contractual principle that damages are awarded only for costs incurred as a result of defendant's breach. McDevitt, 377 So.2d at 192 (citations omitted). This criterion is particularly difficult to satisfy in complex construction cases in which both owner and contractor usually are responsible for delays and disruptions. In these cases, courts will not award "total costs" because such an award would compensate a claimant for its own errors and omissions; See G.M. Shupe, Inc. v. United States, 5 C1. Ct. 662 (1984). Courts will consider several factors in determining whether a contractor is responsible for the added costs, including the claimant's performance and its experience with a particular type of project. See e.g. Servidone Const. Corp. v. United States, 931 F.2d 860, 862

⁴ Claims consultants have suggested that a claimant can establish a reasonable estimate by showing that it was able to achieve estimated productivity rates during "unimpacted" periods of the project. See P. Badala and D. Rapp, Effective Use of Costs Consultants in Resolving Construction Disputes, American Bar Association Forum on the Construction Industry and TIPS Fidelity and Surety Law Committee, 1997. However, this approach requires the claimant to establish an unimpacted period of comparable work. Id.

(Fed. Cir. 1991) (court considers contractor's inexperience with plastic swales at the work site in determining its responsibility for increased costs).

III. DEFEATING TOTAL COST CLAIMS

Courts are reluctant to apply the total cost method because it does not specifically link damages to liability. Defendants generally can defeat a total cost claim by showing that there was a concurrent delay caused by the claimant. In this regard, courts have repeatedly held that when both parties contribute to a delay or disruption, neither can recover damages unless a claimant can clearly establish and allocate each party's portion of the increased costs. Kirk Bros. Mechanical Contractors, Inc. v. Kelso, 16 F.3rd 1173, 1176 (Fed. Cir. 1994); United States v. J.H. Copeland & Sons Construction, Inc., 568 F.2d 1159, 1161 (5th Cir. 1978); Neal and Company, Inc. v. United States, 36 Fed. Cl. 600, 643 (1996). Courts have denied recovery when the claimant has failed to separate its self-inflicted delays and disruptions from those caused by the defendant. See Lichter v. Mellon Stuart Co., 305 F.2d 216 (3rd Cir. 1962), cited with approval by J.H. Copeland, 568 F.2d at 1163.

In Lichter, a subcontractor asserted a "total cost" claim against a contractor for alleged disruptions caused by a piecemeal performance of the work. The court held that even if the subcontractor could establish that the contractor had disrupted the subcontractor's work, the subcontractor could not recover because it had failed to apportion its additional costs between the defendant's actions and other non-actionable causes. Id. at 219. Due to this failure, the Court held that it was proper to reject the subcontractor's entire claim. Id. at 220.

IV. ALTERNATIVES TO THE TOTAL COST METHOD

Courts have held that although difficult to establish, the total cost method is probative evidence concerning the reasonableness of costs and damages; Boyajian, 423 F.2d at 1242. See also Fattore Co. v. Metropolitan Sewer Comm., 505 F.2d 1, 6n, 16 (7th Cir. 1974); S.W. Electric & Mfg. Corp. v. United States, 655 F. 2d 1078, 1089 (Ct. Cl. 1981). In Boyajian, the court noted that the total cost method is a "starting point" that must be refined by appropriate adjustments. Id.⁵

Courts and claimants have attempted to make such appropriate adjustments through the use of the modified total cost method.⁶ See e.g. Servidone Const. Corp. v. United States, 931 F.2d 860 (Fed. Cir. 1991); U.S. For Use and Ben, Evergreen Pipeline v. Merrit, 890 F.Supp 1213, 1222 (S.D.N.Y. 1995). Under this method, the claimant increases its original estimates and decreases its costs of performance to account for errors in the original bid and to account for costs that were not caused by the owner. Id. Courts have also used a modified total cost method by substituting the court's judgment of a reasonable bid amount and deducting costs of performance that were attributable to the contractor. Servidone, 931 F.2d 860.

In Servidone, the Claims Court, following Boyajian approved the use of the total cost method as a "starting point" to determine damages incurred due to differing site conditions. Id. at 861. The trial court had found that the contractor had generally satisfied the total cost requirements except

⁵ For an interesting discussion of the value of the total cost method, See Construction Litigation: Strategies and Techniques, § 6.22, Page 136.

⁶ Florida has not recognized the modified total cost method as an appropriate method for calculating damages.

for the reasonableness of the contractor's estimate. After evaluating extensive testimony, the trial court determined a reasonable bid amount. Id. at 862. The trial court also reduced the contractor's award to account for the contractor's inexperience with the soils at the work site and assessed appropriate overhead, profit and equipment costs. Id.

Although the modified cost method improves the total cost method by accounting for the contractor's estimating and performances errors, it still fails to establish a causal connection between liability and damages.

V. CONCLUSION

Total cost claims are difficult to prove and disfavored by courts, but claimants will continue to assert them because of the potential upside. To avoid proof problems, experienced claimants have become adept at attributing and documenting all of possible overruns to owners or contractors. To counter such measures, one must carefully monitor each project and document all of the claimant's errors and omissions. The surety should also monitor the project to avoid the surprise of substantial claims at the end of a project.