COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT, DIVISION TWO

DILLINGHAM-RAY WILSON, etc., et al., Plaintiffs, Cross-Defendants and Respondents, vs. CITY OF LOS ANGELES, a charter city, Defendant, Cross-Complainant, Appellant and Respondent.	Case No. 2d Civil No. B192900 (Consolidated with 2d Civil No. B196364) Los Angeles County Superior Court No. BC 208414

APPLICATION FOR PERMISSION TO FILE AMICUS BRIEF OF LEAGUE OF CALIFORNIA CITIES, ET AL. IN SUPPORT OF DEFENDANT CITY OF LOS ANGELES

The Honorable Peter D. Lichtman

DENNIS J. HERRERA, State Bar #139669
City Attorney
DANNY CHOU, State Bar # 180240
Chief of Complex and Special Litigation
KATHLEEN MORRIS, State Bar #196672
Deputy City Attorney
Fox Plaza
1390 Market Street, Seventh Floor
San Francisco, California 94102-5408
Telephone: (415) 554-3807
Facsimile: (415) 554-3985
E-Mail: danny.chou@sfgov.org

Attorneys for Amici Curiae
League of California Cities and
California State Association of Counties

COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT, DIVISION TWO

DILLINGHAM-RAY WILSON, etc., et al., Plaintiffs, Cross-Defendants and Respondents, vs. CITY OF LOS ANGELES, a charter city, Defendant, Cross-Complainant, Appellant and Respondent.	Case No. 2d Civil No. B192900 (Consolidated with 2d Civil No. B196364) Los Angeles County Superior Court No. BC 208414

APPLICATION FOR PERMISSION TO FILE AMICUS BRIEF OF LEAGUE OF CALIFORNIA CITIES, ET AL. IN SUPPORT OF DEFENDANT CITY OF LOS ANGELES

The Honorable Peter D. Lichtman

DENNIS J. HERRERA, State Bar #139669
City Attorney
DANNY CHOU, State Bar # 180240
Chief of Complex and Special Litigation
KATHLEEN MORRIS, State Bar #196672
Deputy City Attorney
Fox Plaza
1390 Market Street, Seventh Floor
San Francisco, California 94102-5408
Telephone: (415) 554-3807
Facsimile: (415) 554-3985
E-Mail: danny.chou@sfgov.org

Attorneys for Amici Curiae
League of California Cities and
California State Association of Counties

CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

☒ There are no interested entities or persons to list in this Certificate per California Rules of Court, Rule 8.208.

☐ Interested entities or persons are listed below:

Name of Interested Entity or Person	Nature of Interest
1.	
2.	
3.	
4.	

Please attach additional sheets with person or entity information if necessary.

Dated: June 10, 2009

DENNIS J. HERRERA
City Attorney
DANNY CHOU
Chief of Complex and Special Litigation

By: _____
DANNY CHOU

Printed Name: DANNY CHOU
Deputy City Attorney

Address: Fox Plaza
1390 Market Street, Seventh Floor
San Francisco, CA 94102

State Bar #: 180240

Party Represented: League of California Cities and California State Association of Counties

TABLE OF CONTENTS

TABLE OF AUTHORITIES

State Cases

State Statutes & Codes

Federal Cases

Rules

Constitutional Provisions

Other Authorities

TO THE HONORABLE PRESIDING JUSTICE AND ASSOCIATE JUSTICES OF THE CALIFORNIA COURT OF APPEAL:

Pursuant to rule 8.200(c)(1) of the California Rules of Court, Amici Curiae League of California Cities (League) and California State Association of Counties (CSAC) (collectively, Amici) respectfully request permission to file the brief submitted herewith as amici curiae in support of Defendant, Cross-Complainant, Appellant and Respondent City of Los Angeles.

INTEREST OF AMICUS CURIAE

The League is an association of 480 California cities dedicated to protecting and restoring local control to provide for the public health, safety, and welfare of their residents, and to enhance the quality of life for all Californians. The League is advised by its Legal Advocacy Committee, which is comprised of 24 city attorneys from all regions of the State. The Committee monitors litigation of concern to municipalities, and identifies those cases that are of statewide or nationwide significance. The Committee has identified this case as being of such significance.

CSAC is a non-profit corporation whose membership consists of the 58 California counties. CSAC sponsors a Litigation Coordination Program, which is administered by the County Counsels' Association of California and is overseen by the Association's Litigation Overview Committee, comprised of county counsels throughout the state. The Litigation Overview Committee monitors litigation of concern to counties statewide and has determined that this case is a matter affecting all counties.

Taken together, Amici represent over 500 public entities. Most, if not all, of those entities undertake public works projects that involve contracts like the one at issue in this case on a regular basis. During these projects, these entities often get embroiled in disputes with the contractors or subcontractors. And these disputes, at times, may result in litigation. Amici have carefully considered this case and have determined that the issues raised by this case may have serious consequences for many, if not all, public works projects.

This is so because this case raises numerous issues relating to the legal remedies available in contract disputes between public entities and contractors or subcontractors in public works projects. And the resolution of these issues may determine whether and when certain legal remedies are available in public contract disputes. Thus, Amici all have a common and important interest in many of the issues raised in this case. In particular, they have a strong interest in ensuring that the law governing those remedies is properly construed and does not unduly and improperly harm the public fisc. This is especially true in today's dire economic climate where public entities throughout the state face record deficits. Ultimately, the taxpayers bear the burden when contract recoveries against public entities violate public policy or when penalties are imposed on those entities in violation of the law.

Amici have reviewed the briefs on file in this case to date and do not seek to simply duplicate arguments set forth in those briefs. Rather, they seek to assist the Court by: (1) further explaining the propriety of deciding the availability of certain remedies in disputes involving public contracts through motions in limine; (2) further explaining when certain remedies are not available in such disputes; and (3) clarifying the legal standards that

must be satisfied for an award of the interest penalty and attorney's fees under Public Contract Code section 7107.

Amici respectfully submit that there is a need for additional briefing on these matters and that, based on their experience, they may assist this Court in making a sound decision. Accordingly, Amici respectfully request leave to file the brief submitted herewith.

Dated: June 10, 2009

DENNIS J. HERRERA
City Attorney
DANNY CHOU
Chief of Complex and Special Litigation

By: _____
DANNY CHOU
Attorneys for Amici Curiae
League of California Cities and
California State Association of
Counties

INTRODUCTION

In this case, the City of Los Angeles (L.A.) entered into a construction contract with Dillingham-Ray Wilson (DRW), a private contractor, to upgrade its Hyperion Secondary Sewage Treatment Plant. Contractual disputes arose, and litigation ultimately ensued. During the course of the litigation, the trial court determined, among other things, the legal remedies available to DRW in its breach of contract action against L.A. Review of these determinations in this appeal, however, affects not only this particular dispute between L.A. and DRW. It may also affect disputes between public entities and contractors in numerous other public works projects. Indeed, public entities in California often enter into contracts with private contractors like the one in this case and become embroiled in contractual disputes like the ones in this case.

Together, Amici Curiae the League of California Cities and the California State Association of Counties (collectively, Amici) represent over 500 public entities in California. After reviewing the parties' briefs, Amici have identified several issues raised in this appeal that may have serious consequences for most, if not all, public entities in California. Indeed, the erroneous resolution of these issues may harm the delicate relationship between public entities and their contractors and threaten the public fisc. And taxpayers ultimately shoulder the cost when contract recoveries violate public policy or when penalties are imposed on public entities in violation of the law.

Amici therefore submit this brief in order to assist the Court in resolving these important issues. First, Amici explain that the trial court correctly excluded evidence relating to DRW's total cost theory of damages

at the motion in limine stage because DRW did not establish the prima facie elements necessary to support such a theory. Second, Amici explain that this Court should reverse the award of the two percent interest penalty and attorney's fees under Public Contract Code section 7107 because the jury was never instructed to find, nor did it find, that L.A. lacked both an objectively reasonable basis for withholding contract funds and a subjective belief that it was entitled to any withheld funds.[1] Finally, Amici explain that the two percent interest penalty, if appropriate, should not accrue after entry of judgment.

ARGUMENT

I.

THE TRIAL COURT WAS RIGHT TO EXCLUDE EVIDENCE RELATING TO DRW'S TOTAL COST THEORY OF DAMAGES BECAUSE, AS A MATTER OF LAW, DRW FAILED TO ADDUCE SUFFICIENT EVIDENCE TO WARRANT TOTAL COST RECOVERY.

A. Whether A Plaintiff Has Established The Prima Facie Elements Necessary To Proceed On A Total Cost Theory Is A Question Of Law.

DRW argues that the trial court erred when it excluded evidence offered to support a total cost theory of damages. For the reasons explained below, the trial court's ruling was correct.

In the overwhelming majority of contract cases, a plaintiff that alleges breach(es) of contract must produce admissible evidence that traces a straight line from each individual breach to the damages caused by that particular breach. (*Amelco Electric v. City of Thousand Oaks* (2002) 27 Cal.4th 228, 243 (*Amelco*).) This is because the plaintiff may only recover damages that specifically result from one or more acts of breach, not all of its contract costs. (*Ibid.*)

---

[1] All further statutory references are to the Public Contract Code unless otherwise indicated.

In extremely rare cases, a plaintiff may recover on an alternative theory known as total cost recovery. (*Amelco*, *supra*, 27 Cal.4th at pp. 243-344.) "The total cost method of determining damages is generally disfavored." (*Ibid.*) For public entities, the total cost damages issue is particularly critical because, by definition, total cost recovery means paying an amount that exceeds the original contract amount as reflected in the budget, and the amount agreed-to pursuant to competitive bidding statutes. Such cases can have a major, unexpected impact on the public fisc.[2]

To obtain total cost recovery, a plaintiff has the burden of proving that:

(1) proving actual losses is impractical;

(2) its original bid was reasonable;

(3) its actual costs were reasonable; and

(4) it was not responsible for the added costs. (*Id.* at pp. 242-243.)

Importantly for this case, a plaintiff is not automatically entitled to present the total cost theory of damages to the jury. It may only do so if it has adduced sufficient evidence from which a jury could reasonably conclude it satisfied the four-part test above.

Amelco makes this clear. In *Amelco*, the Supreme Court set forth the process by which a trial court must decide whether a plaintiff may proceed on a total cost theory:

> Before this method may be used, the trial court bears the initial responsibility of determining that each element of the four-part test set forth above can be met. . . . If prima facie evidence under this test is

[2] For this reason, it may well be that total cost recovery is *never* available against a public entity. (See *Amelco,* supra, 27 Cal.4th at p. 242 [expressly leaving open the question of "whether total cost damages are ever appropriate in a breach of public contract case".)

> established, the trier of fact then applies the same test to determine the amount of total cost or modified total cost damages [if any], to which the plaintiff is entitled. (*Amelco*, *supra*, 27 Cal.4th at pp. 243-244.)

Thus, the threshold question of whether the plaintiff has adduced sufficient evidence to make a prima facie showing is one of law. (*Ibid.*; see also *Nebraska Public Power Dist. v. Austin Power, Inc.* (8th Cir. 1985) 773 F.2d 960, 968 [applying nearly-identical Nebraska law] [noting that when plaintiff seeks total cost recovery "the initial responsibility rest[s] with the [trial] court to determine whether there [is] sufficient evidence to create a question of fact. . . ."].)

If a plaintiff fails to produce prima facie evidence on any one of the four factors, the trial court is not only permitted but *required* to bar it from proceeding on a total cost theory.[3] (*See Amelco*, *supra*, 27 Cal.4th at p. 244 [placing on the trial court the "initial responsibility" for testing the weight of the evidence before allowing the jury to consider total cost damages].)

At one point, DRW suggests (as it argued below) that the trial court should have denied the motion in limine because the total cost question is inherently one of fact for the jury. (See Dillingham-Ray Wilson's Appellant's Opening Brief (DRW AOB) 70.) *Amelco* forecloses that argument. In *Amelco*, the question presented was whether the trial court was correct to submit the total cost question to the jury. (*Amelco*, *supra*, 27 Cal.4th at pp. 242-243.) The California Supreme Court found it was not, because the plaintiff had failed to make a prima facie showing on the four total cost factors.

---

[3] By contrast, if a plaintiff does produce evidence from which a reasonable jury could find the presence of each of these factors, the ultimate question of whether the plaintiff is entitled to total cost recovery goes to the jury. (See, e.g., *Nebraska Public Power Dist.* supra, 773 F.2d at p. 968.)

DRW also suggests that L.A.'s conduct during performance of the contract somehow excuses it from having to track specific damages in order to recover for breach, thus entitling it to recover all of its actual costs. (See DRW AOB 78.) Not a single case, state or federal, supports that argument. The trial court was correct to decide the prima facie total cost question as a matter of law.

B. The Trial Court Rightly Concluded That DRW Failed To Produce Sufficient Evidence To Proceed On A Total Cost Theory.

The trial court determined that DRW could not proceed on a total cost theory at the motion in limine stage of the case. The process was straightforward. L.A. filed a motion in limine to exclude DRW's evidence in support of total cost recovery. (Appellant's Appendix (AA) 51-249.) DRW opposed that motion and submitted evidence. (AA 803-936.) L.A. filed a reply. (AA 937-970.) The trial court granted the motion, finding that DRW failed to produce sufficient evidence to proceed to trial on a total cost theory of damages. (AA 996-1012.)

Again, the four total cost factors are: whether calculating damages was impracticable, whether plaintiff's bid and actual costs were reasonable, and whether plaintiff was responsible for the added costs. (*Amelco*, *supra*, 27 Cal.4th at pp. 242-43.) On the question of the practicability of tracking damages, DRW offered scant evidence in opposition to the motion in limine. It rested mainly on the following statement contained in a declaration by one of its engineers:

> The end result of these design changes was to create a complex array of work, a patchwork of sorts, into which was integrated a blending of new, changed work with portions remaining of the City's initial design. As a result, for those tradesmen working in the field who performed the construction of the piping and pipe supports, and the myriad changes the City ordered, it was entirely unfeasible, indeed impossible, for them to

> distinguish in the revised plans and drawings the "new" work from the work that the City originally specified. (AA 820.)

This testimony is legally insufficient to establish that tracking damages breach-by-breach was impracticable. This engineer lacks personal knowledge of what the tradesmen for whom he purports to speak could or could not do. (See Evid. Code, § 702.)[4] And if he is merely repeating what those tradesmen told him, the underlying statements are inadmissible hearsay. (See Evid. Code, § 1200.)[5] Either way, this testimony cannot support proceeding on a total cost theory.

DRW also cites deposition testimony by a City engineer. (See AA 831-832.) DRW claims the engineer testified broadly "that L.A. did not issue change orders based on time and materials" because it was impractical. (DRW AOB 94-95.) In fact, that engineer testified that, with respect to some (unknown) number of (unidentified) change orders, if the parties were unable to reach agreement on the cost of a change under Section 38 of the contract, and it was impracticable to ascertain the extra time and materials involved in that particular change, L.A. would issue a unilateral (rather than time and materials) payment. (See AA 831-832.) This testimony, standing alone, is insufficient to allow total cost recovery on the entire contract or any portion thereof. The engineer does not specify

---

[4] Evidence Code section 702 provides in pertinent part: "the testimony of a witness is inadmissible unless he has personal knowledge of the matter."

[5] Evidence Code section 1200 provides in pertinent part:

> (a) "Hearsay evidence" is evidence of a statement that was made other than by a witness while testifying at the hearing and that is offered to prove the truth of the matter stated.
>
> (b) Except as provided by law, hearsay evidence is inadmissible.

which costs, or even categories of costs, could not be computed on a time-and-materials basis. This evidence is far too thin to constitute prima facie evidence that Dillingham could not have tracked its damages allegedly caused by the City's breach(es).

As for the remaining three factors (DRW's bid and actual costs were reasonable, and it was not responsible for the added costs it is now claiming), DRW attacked L.A.'s evidence, but *failed to make any affirmative evidentiary showing of its own*. Instead, its opposition brief offered the following statements:

> DRW intends at the time of trial to adjust its total costs by deducting those not caused by the City, if any, and adjusting its bid to the extent it contains errors that otherwise render it unreasonable.
>
> As to the factual inaccuracies contained within the City's motion, DRW could, in opposition to this motion, prepare and file declarations consuming tens of pages controverting facts concerning "self-inflicted" costs; but *the City's prima facie showing is so inadequate, it is not considered necessary to burden the Court with lengthy declarations on the myriad factual issues touched upon by the City in its allegations*. Instead, these allegations are addressed below summarily by pointing out how the cited "evidence" does not support the allegations. (AA 809.)

As the italicized portions of the above passage shows, DRW appeared to believe, incorrectly, that L.A. had the burden of producing prima facie evidence *undermining* the four total cost factors set forth in *Amelco*. Instead, DRW had the burden of production and proof on those factors, and utterly failed to meet it. The trial court's ruling was not only correct, but under *Amelco*, it could not have ruled otherwise. (See *Amelco, supra*, 27 Cal.4th at pp. 243-44 [a trial court may not use the total cost method unless it establishes that "each element of the four-part test set forth above can be met]."

C. The Trial Court Did Not Abuse Its Discretion By Considering The Total Cost Theory Of Damages Issue At The Motion In Limine Stage, Rather Than The Jury Instruction Stage, Of The Case.

DRW argues that the trial court erred when it decided the total cost question at the motion in limine stage of the case, rather than allowing all of the evidence in and selecting appropriate theories of damages at the jury instruction stage. The trial court's decision to eliminate a particular measure of damages on a motion in limine is reviewed for an abuse of discretion. (See *Hernandez v. Paicius* (2003) 109 Cal.App.4th 452, 456.)[6] As explained below, DRW's argument lacks merit.[7]

To begin with, DRW cannot argue that it did not have a full and fair chance to develop and present evidence to support a total cost theory of damages. By its own admission, the parties conducted "extensive" discovery for two full years before the motion in limine stage. (DRW AOB 17.) The motion in limine process was straightforward and fair: L.A. filed a motion to exclude evidence to support a total cost theory; DRW filed an opposition and supporting declarations containing facts and attaching documents; and L.A. filed a reply. DRW did not at any point ask the trial court for more time to develop or amass evidence or otherwise prepare to oppose L.A.'s motion in limine.

---

[6] DRW argues that eliminating a measure of damages is akin to eliminating an entire claim on a motion in limine, so the trial court's decision should be reviewed using the substantial evidence standard. (See *Mechanical Contractors Assn. v. Greater Bay Area Assn.* (1998) 66 Cal.App.4th 672, 676-77.) We disagree, but it makes not difference which standard the Court applies in this case; the trial court's actions also easily survive substantial evidence review.

[7] DRW likely waived this argument by failing to raise it below. When the trial court decided to hear the matter on a motion in limine, DRW's only objection was that the total cost recovery question belongs not to the judge, but to the jury. It did not ask the trial court to reconsider the question as a matter of law at the jury instruction stage of the case.

In other words, by the time DRW had to prepare an opposition to Motion in Limine No. 1, and make its case for total cost recovery, DRW had all of the evidence it was ever going to have. From a fairness standpoint, there was no material difference between putting DRW to its proof before rather than after that evidence was presented to a jury.

As one court has observed, motions in limine are an exceedingly useful case management tool. (See *Kelly v. New West Federal Savings* (1996) 49 Cal.App.4th 659, 669.) They "permit more careful consideration of evidentiary issues than would take place in the heat of battle during trial. They minimize side-bar conferences and disruptions during trial, allowing for an uninterrupted flow of evidence. Finally, by resolving potentially critical issues at the outset, they enhance the efficiency of trials and promote settlements." (*Ibid.,* citations and internal quotation marks omitted.)

In this case, the trial court was wise to consider the total cost question on a motion in limine. It would have made no sense to have the parties battle over a massive volume of total cost evidence if DRW was unable to make a prima facie showing necessary for total cost recovery. Given that the total cost theory is "generally disfavored" and should only be used "with caution and as a last resort," the trial court properly determined whether DRW could make a prima facie showing at the motion in limine stage. (*Amelco*, *supra*, 27 Cal.4th at p. 243, internal quotations omitted.) Indeed, courts should make this determination as soon as practicably possible. The trial court did not abuse its discretion in taking this approach.

II.

THE INTEREST PENALTY AND ATTORNEY'S FEE AWARD SHOULD BE REVERSED BECAUSE THE JURY NEVER FOUND THAT L.A. LACKED BOTH AN OBJECTIVELY REASONABLE BASIS FOR WITHHOLDING CONTRACT FUNDS AND A SUBJECTIVE BELIEF THAT THE WITHHELD FUNDS WERE IN DISPUTE.

Amici agree with L.A. that the award of the two percent interest penalty and attorney's fees and costs pursuant to section 7107, subdivision (f) should be reversed. But rather than repeat L.A.'s cogent arguments here, Amici apply the rules of statutory construction to further clarify the findings that are necessary to support such an award. Amici then explain why the interest penalty and attorney's fee award should be reversed because the jury failed to make these requisite findings.

Under longstanding rules of statutory construction, courts "consider the nature and purpose of the statutory enactment" (*Fernandez v. California Dept. of Pesticide Regulation* (2008) 164 Cal.App.4th 1214, 1233), and adopt "the construction that best harmonizes the statute internally and with related statutes" (*People v. Superior Court (Zamudio)* (2000) 23 Cal.4th 183, 192-193, internal quotations omitted). In doing so, courts should make a particular effort to harmonize different subdivisions within a statute. (See *Wilcox v. Birtwhistle* (1999) 21 Cal.4th 973, 978-979 (*Wilcox*).) Courts should also give meaning to every word in a statute and should not adopt a "judicial construction that renders part of the statute 'meaningless or inoperative.' " (*Hassan v. Mercy Am. River Hosp.* (2003) 31 Cal.4th 709, 715-716 (*Hassan*).) Finally, courts may consider legislative history materials when construing ambiguous statutory language. (*Big Creek Lumber Co. v. County of Santa Cruz* (2006) 38 Cal.4th 1139, 1153.)

Application of these rules reveals that, under section 7107, subdivision (c), a public entity may withhold contract funds for over 60

days if the entity has either an objectively reasonable basis for doing so or a subjective belief that the funds are in dispute. If a public entity withholds funds in accordance with subdivision (c), then the entity is neither subject to an interest penalty nor obligated to pay attorney's fees and costs under subdivision (f). In this case, the jury was not instructed to find, nor did it find, that L.A. lacked either an objectively reasonable basis for withholding contract funds or a subjective belief that the withheld funds were in dispute. Accordingly, the interest penalty and fee awards should be reversed.

A. Under Section 7107, Subdivision (c), A Public Entity May Withhold Contract Funds For Over 60 Days If The Entity Has Either An Objectively Reasonable Basis For Doing So Or A Subjective Belief That The Funds Are In Dispute.

DRW agrees that, under section 7107, subdivision (c), a public entity may withhold contract funds for more than 60 days if those funds are disputed. (Dillingham-Ray Wilson's Combined Appellant's Reply Brief and Cross-Respondent Brief (DRW Reply) 116-117.) DRW also agrees that in construing subdivision (c) – which allows a public entity to withhold contract funds "in the event of a *dispute*" (italics added) – the Court should consider subdivision (e) – which allows a private contractor to withhold contract funds only if a "*bona fide dispute*" exists (italics added) – and the legislative history. (DRW Reply 118-119.) Although DRW correctly identifies what the Court should consider, it misapplies or ignores the pertinent rules of statutory construction. The correct application of these rules reveals that a public entity may withhold contract funds for over 60 days if the entity has either an objectively reasonable basis for doing so or a subjective belief that the funds are in dispute.

Section 7107, subdivision (c) provides that:

> Within 60 days after the date of completion of the work of improvement, the retention withheld by the public entity shall be released. *In the event of a dispute between the public entity and the original contractor*, the public entity may withhold from the final payment an amount not to exceed 150 percent of the disputed amount. (Italics added.)

By its terms, section 7107, subdivision (c) allows a public entity to withhold contract funds for more than 60 days "[i]n the event of a dispute between the public entity and the original contractor." (See also State & Consumers Services Agency, Enrolled Bill Rep. on Assem. Bill No. 1702 (1991-1992 Reg. Sess.) Sept. 24, 1992, p. 1 ["In the case of a dispute, the public entity may withhold from the final payment 150 percent of the disputed amount; the 60 day period does not apply to the funds retained on disputed matters"].) It does not, however, define the sorts of "dispute[s]" that would justify the withholding of funds beyond 60 days.

But other subdivisions of section 7107 do provide guidance. (See *Wilcox*, *supra*, 21 Cal.4th at p. 978-979 [harmonizing subdivisions of statute].) Subdivision (e) states in relevant part that:[8]

> The original contractor may withhold from a subcontractor its portion of the retention proceeds if a *bona fide dispute* exists between the subcontractor and the original contractor. (Italics added.)

By its terms, subdivision (e) limits the disputes that would justify the withholding of contract funds by an original contractor from a subcontractor to "bona fide dispute[s]." Although subdivision (e) does not define a "bona fide dispute," courts have regularly construed this phrase in analogous statutes and contexts as establishing an objective standard. (See, e.g., *Schlossberg v. Byrd (In re Byrd)* (4th Cir. 2004) 357 F.3d 433, 437

[8] Section 7107, subdivision (e) also provides that "[t]he amount withheld from the retention payment shall not exceed 150 percent of the estimated value of the disputed amount."

["We agree . . . with the unanimous view of our sister circuits that a bona fide dispute requires 'an objective basis for either a factual or a legal dispute as to the validity of [the] debt' "]; *Liberty Tool, & Manuf. v. Vortex Fishing System, Inc. (In re Vortex Fishing System, Inc.)* (9th Cir. 2002) 277 F.3d 1057, 1064 [same]; *Shaw v. County of Santa Cruz* (2008) 170 Cal.App.4th 229, 264 ["an agency's position advocated in a bona fide dispute must be plausible or objectively reasonable even though it may later be determined to be erroneous"]; see also *Forty-Niner Truck Plaza, Inc. v. Union Oil Co. of California* (1997) 58 Cal.App.4th 1261, 1281 [construing "bona fide" as requiring objective analysis].) An original contractor may therefore withhold funds from a subcontractor only if the contractor has an *objectively reasonable* basis for doing so. Thus, a contractor withholds funds in violation of subdivision (e) only if no reasonable contractor would believe that it is entitled to those funds.

Because the term "dispute" as used in section 7107, subdivision (c) has no limiting modifier, it necessarily encompasses a "bona fide dispute." Thus, the existence of a bona fide dispute must justify the withholding of contract funds by a public entity. And a public entity may, at a minimum, withhold funds for over 60 days if that entity has an objectively reasonable basis for doing so.

But a bona fide dispute cannot be the only sort of dispute that would justify the withholding of contract funds by a public entity under section 7107, subdivision (c). If the word "dispute," as used in subdivision (c), just meant a "bona fide dispute," then the word "bona fide," as used in subdivision (e), would become superfluous. Such a construction would violate longstanding rules of statutory construction. (See *Hassan, supra*, 31

Cal.4th at pp. 715-716 [should not adopt construction that " renders part of the statute 'meaningless or inoperative' "].)

A public entity must therefore be able to withhold contract funds for over 60 days under section 7107, subdivision (c) even if no bona fide dispute exists.[9] In determining when a public entity may withhold funds in the absence of a bona fide dispute, the legislative history is instructive. That history explains that the Legislature enacted section 7107 to insure that public entities act in "good faith":

> The author believes it is particularly appropriate that public agencies *act in good faith* when administering contracts in the name of the people of California. This measure creates a workable and fair system to insure *good faith* in the retention disbursement process. (Sen. Com. on Governmental Organization, Staff Analysis of Assem. Bill No. 1702 (1991-1992 Reg. Sess.) as amended June 28, 1992, p. 2, italics added.)

In light of this stated purpose, the Legislature undoubtedly intended to allow a public entity to withhold contract funds whenever the entity acts in "good faith." " 'Good faith, or its absence, involves a factual inquiry into the [entity's] *subjective state of mind.* [Citations]: Did [it] believe the action was valid? What was [its] intent or purpose in pursuing it?' " (*Alpha Mechanical, Heating & Air Conditioning, Inc. v. Travelers Cas. & Surety Co. of America* (2005) 133 Cal.App.4th 1319, 1339 (*Alpha Mechanical*),

---

[9] Before the trial court, L.A. suggested that "bona fide" and "good faith" have the same meaning. (AA 2530.) As explained above, even if that is generally true, the phrase "bona fide dispute" establishes an objective standard. In any event, even if the phrase "bona fide dispute" did establish a subjective "good faith" standard, the result would be the same. Because a "dispute" necessarily encompasses a "bona fide dispute," a public entity must be able to withhold contracts funds for over 60 days even if there is no bona fide dispute. Thus, if a bona fide dispute requires only a subjective belief that the public entity is entitled to the funds, then that entity must be able to withhold funds absent such a belief. Presumably, a public entity should only be able to do so if it had an objectively reasonable basis for withholding the funds.

quoting *Knight v. City of Capitola* (1992) 4 Cal.App.4th 913, 932, italics added.) A public entity therefore withholds contract funds in good faith whenever that entity "subjectively" believes that it is entitled to those funds. (*Alpha Mechanical*, at p. 1340.)

Thus, under section 7107, subdivision (c), a public entity improperly or wrongfully withholds contract funds only if the entity lacks both an objectively reasonable basis for doing so and a subjective belief that it is entitled to those funds. If a public entity has a subjective (albeit mistaken) belief that it is entitled to contract funds, then the entity may withhold those funds even if its belief is not objectively reasonable. This is because the entity has acted in good faith. And if an entity has an objectively reasonable basis for withholding contract funds, then the entity may withhold those funds even if it subjectively (albeit mistakenly) believes otherwise. This is because a bona fide dispute exists.

Allowing public entities to withhold contract funds even in the absence of a bona fide dispute is consistent with the unique responsibility that these entities bear. Unlike private contractors, public entities are the constitutionally-appointed guardians of the public fisc. Thus, the Legislature may not "make any gift or authorize the making of any gift, of any public money or thing of value to any individual, municipal or other corporation whatever . . . ." (Cal. Const., art. XVI, § 6.) It also

> has no power to grant, or to authorize a county, or other public body to grant extra compensation or extra allowance to a public officer, public employee or contractor after service has been rendered or a contract has been entered into and performed in whole or in part, or to authorize the payment of a claim against the State or a city, county, or other public body under an agreement made without authority of law. (Cal. Const., art. IV, § 17.)

The California Constitution places similar constraints on local government bodies. (See Cal. Const., art. XI, § 10.)

In light of their constitutional duty to safeguard the public fisc, public entities must err on the side of caution and release contract funds *only* when they are certain that the contractor is entitled to those funds. Indeed, "[i]f the funds are released and then a finding is made that the contractor is not eligible for them, this would be considered risking state funds." (State & Consumer Services Agency, Revised Bill Analysis of Assem. Bill No. 1702 (1991-1992 Reg. Sess.) May 30, 1991, p. 3.) Recognizing this, the Legislature not only allows public entities to withhold contract funds up to 60 days without a dispute,[10] it also allows those entities to withhold funds for more than 60 days if there is a either a bona fide or a good faith dispute over those funds. Accordingly, under section 7107, subdivision (c), a public entity may withhold contract funds if it has either an objectively reasonable basis for doing so or a subjective belief that the funds are in dispute.

B. Because The Jury Did Not Find That L.A. Lacked Both An Objectively Reasonable Basis for Withholding Funds And A Subjective Belief That The Withheld Funds Were In Dispute, The Interest Penalty Award Should Be Reversed.

Under section 7107, subdivision (f), a contractor may only recover the two percent per month interest penalty "on the improperly withheld amount" "[i]n the event that retention payments are not made within the time period required by this section." As explained above, a public entity may withhold retention payments for over 60 days if that entity has either

[10] By contrast, an original contractor may only withhold contract funds from a subcontractor for *seven* days in the absence of a bona fide dispute over those funds. (See § 7107, subd. (d).)

an objectively reasonable basis for doing so or a subjective belief that it is entitled to those funds. (See *ante,* at pp. 14-19.) Because the jury was not instructed to find, nor did it find, that L.A. lacked both an objectively reasonable basis for withholding contract funds and a subjective belief that the withheld funds were disputed, the trial court could not find that L.A. improperly withheld any funds. The two percent interest penalty award should therefore be reversed.

The interest penalty provision of section 7107, subdivision (f) states in relevant part that:

> In the event that retention payments are not made within the time period required by this section, the public entity or original contractor withholding the unpaid amounts shall be subject to a charge of 2 percent per month on the improperly withheld amount, in lieu of any interest otherwise due.

By its terms, subdivision (f) only permits an interest penalty award if the public entity failed to make any payments "within the time period required by" section 7107. Subdivision (c) defines the time periods within which a public entity must release withheld contract funds. Thus, a contractor may only recover the interest penalty if the public entity withholds funds in violation of subdivision (c).

Subdivision (c) allows a public entity to withhold payment of disputed contract funds for over 60 days so long as the entity has either an objectively reasonable basis for doing so or a subjective belief that it is entitled to those funds. (See *ante*, at pp. 14-19.) Thus, DRW may only recover the interest penalty if the jury found that L.A. lacked both an objectively reasonable basis for withholding contract funds and a subjective belief that it was entitled to the withheld funds.

But the jury made no such finding. The jury was instructed that

> Section 7107 of the Public Contract Code requires public agencies to pay to the contractor retention within 60 days of the completion of the work.
>
> The act also provides that if the public agency disputes its liability for the payment in good faith within the sixty day period, it may hold an amount not to exceed 150 percent of the "disputed" amount.
>
> However, if it is later determined that the withholding was unreasonable in light of all of the circumstances that existed at the time, the public entity is liable for penalty interest. (RA 648.)

Under this instruction, the jury only had to determine whether "the withholding was unreasonable." (RA 648.) It never had to determine whether the withholding was "unreasonable" because no dispute existed. And it certainly never had to determine whether L.A. lacked both an objectively reasonable basis for withholding contract funds and a subjective belief that it was entitled to the withheld funds. Thus, when the jury found that "the City's action in assessing liquidated damages" was not "reasonable," it did not find that no dispute over the withheld funds existed. Nor did the jury find that L.A. lacked both an objectively reasonable basis for assessing liquidated damages and a subjective belief that it was entitled to such damages.[11] (AA 2673.) Even if the jury's finding could be construed as a finding that L.A.'s action in assessing liquidated damages was not objectively reasonable, it cannot be construed as a finding that L.A. lacked a subjective belief that it was entitled to liquidated damages.

---

[11] The special verdict form stated in relevant part:

> **PUBLIC CONTRACT CODE SECTION 7107 CLAIM AGAINST CLA**
>
> 4. Considering all the factual circumstances that existed at the time, was the City's action in assessing liquidated damages reasonable?
>
> _____ Yes __X__ No

Because the jury did not make the findings necessary for an interest penalty award under section 7107, subdivision (f), that award should be reversed.

C. If The Court Reverses The Two Percent Interest Penalty Award, It Should Also Reverse Attorneys Fee Award Pursuant To Section 7107, Subdivision (F).

If this Court reverses the award of the two percent interest penalty, it should also reverse the award of attorney's fees and costs pursuant to section 7107, subdivision (f). And this Court should do so even if it affirms the award of withheld contract funds to DRW.

In section 7107, subdivision (f), the attorney's fee provision follows immediately after the interest penalty provision and provides that:

> *Additionally*, in any action for the collection of funds wrongfully withheld, the prevailing party shall be entitled to attorney's fees and costs. (Emphasis added.)

By using the word "[a]dditionally" as the bridge between the interest penalty provision and the attorney's fee provision, the Legislature tied the interest award to the fee award. Thus, any fee award to a plaintiff must be in addition to an interest penalty award to that plaintiff. And if the plaintiff is not entitled to the interest penalty, then it is not entitled to fees and costs under section 7107, subdivision (f).

Such a construction is confirmed by other language in section 7107, subdivision (f). Like the interest penalty provision – which only imposes interest on the "improperly withheld amount" – the attorney's fee provision only provides for a fee award to the party that prevailed in an "action for the collection of funds *wrongfully withheld*." (§ 7107, subd. (f), italics added.) As explained above, L.A. "wrongfully withheld" contract funds *only if* L.A. withheld those funds in violation of subdivision (c). Because the jury did not find that L.A. did so, DRW is not entitled to fees or costs under subdivision (f). (See *ante*, at pp. 19-22.)

Any other construction would render the words "[a]dditionally" and "wrongfully" in section 7107, subdivision (f) superfluous. (See *Hassan*, *supra*, 31 Cal.4th at pp. 715-716.) Indeed, holding that an attorney's fee award is appropriate even through an interest penalty award is not makes no sense where, as here, the statutory fee provision is located in the same subdivision as the interest penalty provision and immediately follows that provision. (See *Sanchez v. Workers' Comp. Appeals Bd.* (1990) 217 Cal.App.3d 346, 354-355 [considering location of statutory language within statutory scheme in construing that language].) If the Legislature had intended to award fees and costs regardless of whether the plaintiff obtained an interest penalty, it would have omitted the word "[a]dditionally" and placed the fee provision in a separate statute or subdivision.

The legislative history confirms this. To ensure that a public entity may withhold funds in dispute without penalty, the Legislature made it clear that the penalty provisions of section 7107 only applied to "funds *wrongfully* withheld" by the public entity. (Sen. Com. on Governmental Organization, Staff Analysis of Assem Bill No. 1702, *supra*, as amended June 28, 1992, at p. 1, italics added.) Thus, a contractor may recover *both* the interest penalty and fees and costs only if the public entity lacked both an objectively reasonable basis for withholding disputed funds and a subjective belief that it was entitled to the disputed funds.

> If the funds *that are not disputed* are not released, as prescribed by either the public entity or the prime contractor, they will be charged two percent interest per month. *In addition*, if there is any action necessary for the release of *these* funds [-- i.e., the undisputed funds --], the prevailing party would be entitled to attorney's fees and costs. (State & Consumer Services Agency, Revised Bill Analysis of Assem. Bill No. 1702, *supra*, May 30, 1991, p. 2, italics added.)

Conversely, a contractor may not recover *either* the interest penalty or fees and costs if the public entity had either an objectively reasonable basis for withholding disputed funds or a subjective belief that it was entitled to the disputed funds.

Another Court of Appeal reached the identical conclusion in construing Civil Code section 3260 – the model for Public Contract Code section 7107. (See Sen. Com. on Governmental Organization, Staff Analysis of Assem. Bill No. 1702, *supra*, as amended June 28, 1992, p. 2 ["This measure would enact similar safeguards [as Civil Code section 3260] against the abuse of the retention system for public works projects"].) In *Denver D. Darling, Inc. v. Controlled Environments Construction, Inc.* (2001) 89 Cal.App.4th 1221, 1241, the Court of Appeal held that a party who recovered withheld funds may not recover fees and costs if it did not recover the two percent interest penalty. Accordingly, the award of attorney's fees under section 7107, subdivision (f) should be reversed if the Court reverses the interest penalty award.

III.

THE TWO PERCENT INTEREST PENALTY SHOULD NOT ACCRUE AFTER ENTRY OF JUDGMENT.

According to L.A. the two percent interest penalty should not accrue after entry of judgment. In support, L.A. relies on *S&S Cummins Corp. v. West Bay Builders, Inc.* (2008) 159 Cal.App.4th 765, 780 and explains that "[t]he entry of judgment extinguished the rights upon which DRW's suit to recover the retention was based – including its right to interest at the penalty rate." (Combined Respondent's Brief and Appellant's Opening Brief of the City of Los Angeles 128-129.) Amici agree and do not repeat L.A.'s arguments here. Instead, Amici offer two additional reasons why the penalty should not accrue after entry of judgment: (1) such a construction

comports with the purpose behind section 7107; and (2) a contrary interpretation would unconstitutionally punish a public entity for appealing from an adverse judgment.

In enacting section 7107, the Legislature sought to prevent a public entity from using "retentions as an interest free 'float' at the expense of the general contractor and the subcontractors." (Assem. Com. on Consumer Protection, Governmental Inefficiency and Economic Development, Analysis of Assem. Bill No. 1702 (1991-1992 Reg. Sess.) as introduced Mar. 8, 1991, p. 1.) The entity could use withheld funds as an interest free float because it would suffer no adverse consequences from withholding the funds until the contractor obtained a legal judgment against it. Indeed, absent a judgment, the contractor had no way of forcing the entity to release any funds. Thus, the Legislature enacted the two percent penalty in order to encourage public entities to release undisputed funds *before* the contractor was forced to obtain a judgment.

Such encouragement is no longer necessary after the contractor obtains a legal judgment against the public entity. With a judgment in hand, the contractor may force the entity to pay through a "writ of mandate." (Gov. Code, § 970.2.) Thus, the interest penalty is no longer necessary to encourage the public entity to release any withheld funds *after* entry of judgment because the entity faces the specter of a writ of mandate.

Finally, allowing the two percent penalty to accrue after entry of judgment would unconstitutionally penalize a public entity for appealing from an adverse judgment. Under both the federal and California constitutions, a public entity has a right of access to the courts. (U.S. Const., art. III; Cal. Const., art. VI, § 1.) Imposing the interest penalty after judgment has been entered even where, as here, a public entity has a tenable

basis for appeal is therefore improper. (See *In re Marriage of Flaherty* (1982) 31 Cal.3d 637, 650 [parties should not be deterred from filing a nonfrivolous appeal "out of a fear of reprisals"].)

CONCLUSION

Public entities in California have a constitutional duty to protect the public fisc. This duty is especially important today where virtually every public entity faces massive deficits. Recognizing this, both California courts and the Legislature have instituted important safeguards designed to protect the public fisc. This Court should apply these safeguards here by affirming the exclusion of evidence relating to DRW's total cost theory of damages at the motion in limine stage and by reversing the award of the two percent interest penalty and attorney's fees pursuant to section 7107, subdivision (f). In the alternative, this Court should hold that the two percent interest penalty does not accrue after entry of judgment.

Dated: June 10, 2009

DENNIS J. HERRERA
City Attorney
DANNY CHOU
Chief of Complex and Special Litigation

By: 
DANNY CHOU
Attorneys for Amici Curiae
League of California Cities and
California State Association of
Counties

CERTIFICATE OF COMPLIANCE

I hereby certify that this brief has been prepared using proportionately double-spaced 13 point Times New Roman typeface. According to the "Word Count" feature in my Microsoft Word for Windows software, this brief contains 7,478 words up to and including the signature lines that follow the brief's conclusion.

I declare under penalty of perjury that this Certificate of Compliance is true and correct and that this declaration was executed on June 10, 2009.

DENNIS J. HERRERA
City Attorney
DANNY CHOU
Chief of Complex and Special Litigation

By: _____
DANNY CHOU
Attorneys for Amici Curiae
League of California Cities and
California State Association of
Counties

PROOF OF SERVICE

I, MARTINA HASSETT, declare as follows:

I am a citizen of the United States, over the age of eighteen years and not a party to the above-entitled action. I am employed at the City Attorney's Office of San Francisco, Fox Plaza Building, 1390 Market Street, Seventh Floor, San Francisco, CA 94102.

On June 10, 2009, I served the following document(s):

APPLICATION FOR PERMISSION TO FILE AMICUS BRIEF OF LEAGUE OF CALIFORNIA CITIES, ET AL. IN SUPPORT OF DEFENDANT CITY OF LOS ANGELES

on the following persons at the locations specified:

SEE ATTACHED SERVICE LIST

in the manner indicated below:

☒ **BY UNITED STATES MAIL**: Following ordinary business practices, I sealed true and correct copies of the above documents in addressed envelope(s) and placed them at my workplace for collection and mailing with the United States Postal Service. I am readily familiar with the practices of the San Francisco City Attorney's Office for collecting and processing mail. In the ordinary course of business, the sealed envelope(s) that I placed for collection would be deposited, postage prepaid, with the United States Postal Service that same day.

I declare under penalty of perjury pursuant to the laws of the State of California that the foregoing is true and correct.

Executed June 10, 2009, at San Francisco, California.

Martina Hassett

MARTINA HASSETT

SERVICE LIST

Dillingham-Ray Wilson v. City of Los Angeles
2d Civil No. B192900 (Consolidated with 2d Civil No. B196364)

Patrick J. Duffy
Monteleone & McCrory, LLP
725 S. Figueroa Street, Suite 3750
Los Angeles, CA 90017-5446

Clerk to:
Honorable Peter D. Lichtman
Dept. 322
Los Angeles Superior Court
600 South Commonwealth Ave.,
Los Angeles, CA 90005

Gregory J. Dukellis
Watt Tieder Hoffar &
Fitzgerald LLP
2040 Main Street, Suite 300
Irvine, CA 92614
Attorneys for Plaintiffs, Cross-Defendants and Respondents, DILLINGHAM-RAY WILSON, etc., et al.

California Supreme Court
San Francisco Office
350 McAllister Street
San Francisco, CA 94102
Four copies

Timothy L. Pierce
Kirkpatrick Lockhart et al.
10100 Santa Monica Blvd., 7th Fl.
Los Angeles, CA 90067
Attorneys for Respondent CBI Services, Inc.

Courtesy copies:

Christopher F. Wilson
21535 Hawthorne Boulevard, Ste. 260
Torrance, CA 90405

Rockard J. Delgadillo
City Attorney
Michael L. Claessens
Assistant City Attorney
OFFICE OF THE LOS ANGELES CITY ATTORNEY
200 North Main Street, 6th Floor
City Hall East
Los Angeles, CA 90012

Philip A. Toomey
Artiano Guzman & Toomey LLP
3828 Carson Street, Suite 102
Torrance, CA 90503 -6706

Barry J. Jensen
Monteleone & McCrory LLP
450 W. 4th Street, Suite 130
Santa Ana, CA 92701

Irving H. Greines
Feris M. Greenberger
Peter O. Israel
GREINES, MARTIN, STEIN & RICHLAND LLP
5900 Wilshire Boulevard, 12th Fl.
Los Angeles, CA 90036

E. Scott Holbrook
Crawford & Bangs LLP
1290 E. Center Court Drive
Covina, CA 91724

Nowland C. Hong
David P. Dapper
Akerman Senterfitt
Michael S. Simon
AKERMAN SENTERFITT LLP
725 S. Figueroa Street, 38th Fl.
Los Angeles, CA 90017
Attorneys for Defendant, Cross-Complainant, Appellant and Respondent CITY OF LOS ANGELES

Ted R. Gropman
Law Office Ted R. Gropman
21800 Oxnard Street, Suite 430
Woodland Hills, CA 91367