

STATE OF TRUK, ex rel.  
YOSIUO SWAIN, et al., Plaintiffs-Appellants

v.

ERHART ATEN, GOVERNOR OF TRUK STATE, et al.,  
Defendants-Respondents

Civil Appeal No. 432

Appellate Division of the High Court

Truk Territory Division

September 22, 1988

Appeal following remand of suit by public employees alleging "privatization program" of former governor of the State of Truk violated various laws. The Appellate Division of the High Court, Tevrizian, Associate Justice, affirmed in part, reversed in part, and remanded for findings consistent with its opinion.

**1. Appeal and Error—Findings and Conclusions—Clearly Erroneous**

A finding is clearly erroneous when, although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed. (6 TTC § 355(2)).

**2. Appeal and Error—Scope of Review—Facts**

Appellate court does not reweigh facts *de novo*.

**3. Appeal and Review—Evidence—Weight**

If the district court's account of the evidence is plausible in light of the record viewed in its entirety, the court of appeal may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently.

**4. Appeal and Review—Evidence—Weight**

Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous.

**5. Appeal and Error—Findings and Conclusions—Supporting Evidence**

Where private contractors and government officials admitted that they conspired in a kickback scheme related to a government contract but a permissible view of credible evidence supported trial court's finding that no fraud or collusion affected the contract, inasmuch as no kickbacks were actually paid and no prices were padded, trial court's finding was not clearly erroneous.

**6. Appeal and Error—Findings—Supporting Evidence**

Where plausible evidence relied upon by the trial court supported its findings respondents entered into and completed a government contract in good faith, the findings were not clearly erroneous.

**7. Appeal and Error—Remand**

Where Appellate Division previously found that government contracts violated several laws and were invalid and stated in its remand order that respondents had to overcome a presumption that they were aware of the effect of these laws to recover on quantum meruit for work performed on the contracts, trial court's conclusion as a matter of law that respondents overcame the presumption of knowledge of the State of Truk's contracting requirements because they knew at the time they entered the agreements by negotiation that such a procedure was legal, did not address the Appellate Division's concern for violation of other laws or its specific instructions.

**8. Appeal and Error—Burden of Proof**

Where trial court erroneously shifted the burden to appellants to prove that respondents entered into a government contract in bad faith, its finding that the contract was entered into in good faith was erroneous.

**9. Appeal and Error—Harmless Error—Particular Errors**

Where trial court abused its discretion in excluding two pages of a deposition at trial but there was no showing that the excluded pages would have affected the trial court's ruling, reversible error did not exist.

**10. Contracts—Quantum Meruit**

Quantum meruit is an equitable doctrine based on concept that no one who benefits by the services or goods provided by another should be unjustly enriched thereby; under such circumstances, the law implies a promise to pay a reasonable amount for the services or goods furnished, even absent a specific contract therefor.

**11. Contracts—Quantum Meruit**

Where respondents sought quantum meruit recovery for work performed on contracts entered into with the State of Truk, trial court was to establish quantum meruit on the basis of the reasonable value of the goods and services rendered by respondents to the State of Truk, and in no event could the trial court find that quantum meruit exceeded the contract price for any specific contract entered into.

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*Counsel for Defendant-  
Respondent:*

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Manual D. Crisostomo, Inc.  
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*Counsel for Defendant-  
Respondent:*

*ECCG (Electrical Contract-  
ing Corporation of Guam)  
and L. D. Williamson*

GEORGE M. BUTLER, ESQ., and  
ROBERT L. KEOGH, ESQ.

Before MUNSON, *Chief Justice*, KOZINSKI\*, *Associate  
Justice*, TEVRIZIAN\*\*, *Associate Justice*

TEVRIZIAN, *Associate Justice*

*Background of the Case*

A. Procedural Background

Erhart Aten was Governor of Truk State from 1978 to 1985. He instituted a "privatization program" beginning in 1981 in which various public works projects of Truk State were contracted to the private sector.

On December 22, 1983, appellants, who were nineteen employees of the Truk State Department of Public Works (DPW), received notices that they would be terminated from their positions at DPW. These terminations resulted from the privatization program.

On February 3, 1984, the appellants, as private attorneys general pursuant to the Truk State Financial Management Act, filed a complaint for declaratory and injunctive relief against Erhart Aten, then Governor of the State of Truk, and Patrick Mackenzie, then Director of the Department of Finance of the State of Truk. The suit alleged that the privatization program violated the Executive Branch Organization Act of 1980 and the Truk State Public Service System Act. The thrust of Swain's complaint was that the privatization program resulted in work going to private contractors that was normally performed by the DPW.

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\* Justice of the Court of Appeals for the Ninth Circuit.

\*\* Judge of the United States District Court for the Central District of California, designated as Temporary Justice by the United States Secretary of the Interior.

Additionally, appellants alleged that public funds had not been appropriated for payment of these contracts. Moreover, incurring these obligations without available funds violated the Truk State Charter, the State Budget Act of 1982, and the State Financial Management Act. Finally, appellants argued that monies paid pursuant to these contracts divested public funds away from other public services normally provided by Truk State to its citizens.

Appellants sought injunctive relief precluding the termination of their jobs. They also sought a declaratory judgment that Governor Aten had violated the above laws and an injunction mandating future compliance with these laws. Finally, appellants sought to have the contracts declared null and void and for a return of all monies paid.

After a hearing on February 6, 1984, the trial court issued a preliminary injunction restraining Governor Aten from terminating appellants' employment, and prohibiting Governor Aten from disbursing public funds to private sector businesses for the type of work previously performed by the DPW. A preliminary injunction incorporating the preliminary order was issued on February 17, 1984.

Prior to the initial trial, appellants filed a first amended complaint. The trial court permitted Governor Aten to file a third party complaint against the private contractors to whom Governor Aten had awarded the contracts. The private contractors, who are the respondents herein, including Manual D. Crisostomo and his company MDCI, Inc., and L. W. Williamson and his company ECCG, Inc., answered and counterclaimed for quantum meruit for all work performed and materials supplied. Also the Special Investigating Committee of the Truk Legislature intervened as a party plaintiff.

The court permitted appellants to file a second amended complaint, which sought: (1) to have 23 contracts between the respondents and Truk State declared void *ab initio* on

the ground of fraud and collusion; (2) to have five of the 23 contracts declared void for violating the Public Contracts Act; (3) to have all contracts declared void for violating the laws enumerated in the complaint and first amended complaint; (4) a declaratory judgment that Truk State was not liable for any sums owing under the specified contracts; and (5) a judgment for damages in excess of \$1.6 million to Truk State from the third party defendants.

At the beginning of the initial trial in August, 1985, the trial court entertained numerous motions and among its various rulings, it dismissed the Truk State legislative committee as a plaintiff-intervenor; it suppressed the deposition of Charles Boddy, Director of the Department of Public Works; and it prevented the legislative committee's counsel, Mr. Bruce, from serving as co-counsel for appellants.

The trial court dismissed defendant Mackenzie following the presentation of plaintiff's case, and dismissed the case after a six day trial. Swain appealed. The Appellate Division ordered the trial court to enter a written judgment, which it did on March 7, 1986, *nunc pro tunc* to August 31, 1985. On July 14, 1986, appellants moved for judgment, which the Appellate Division denied. The Appellate Division heard oral arguments on October 10, 1986. In its opinion of November 17, 1986, the Appellate Division ruled that the contracts were void and unenforceable as a matter of law. The Appellate Court issued a Remand Order specifically instructing the Trial Division to admit specific pieces of evidence (the 1983 Touche Ross Audit Report, the Boddy-Crisostomo Joint Venture Agreement, and portions of the deposition of Charles Boddy), and to:

1. Permit appellants to complete presentation of their case;
2. Place the burden of proof upon respondents to establish their good faith in entering into the disputed contracts; and

projects. The entity was a Joint Venture between respondent ECCG, Inc., a Guam corporation of which respondent L. W. Williamson is principal owner and officer, and respondent MDCl, Inc., a Guam corporation of which respondent Manual D. Crisostomo is principal owner and officer.

Williamson submitted a cost estimate for this Water Resources Contract (WR GA-056) to Truk State in July or August of 1981, based on projects the Joint Venture had done as a subcontractor for a certain Maeda Construction Inc., and estimated costs in the amount of \$3.157 million.

In August and September Governor Aten discussed the estimate with officials of the Trust Territory of Saipan, conducted meetings with Joint Venture representatives, and compared the estimate to an estimate prepared by another contractor which was considerably higher. On September 24, 1981, Truk State accepted the estimate in a negotiation between Boddy, Crisostomo, and Williamson.

The following day in a meeting with private contractors Crisostomo and Williamson, Truk State officials Boddy and Baker discussed a scheme wherein the Joint Venture would kickback to them 10% of the Joint Venture's profits on the contract. The Joint Venture agreed to pay them \$282,000 out of the earnings once the full contract price was paid. The trial court on remand found the scheme had no effect on the actual cost of the project to Truk State.

The contract was executed on October 2, 1981, but was soon cancelled because the Trust Territory refused to approve full funding. No funds were disbursed or paid to Boddy and Baker under this purported contract.

On November 1, 1981, Truk State and the Joint Venture entered into a contract for Well Drilling only (CT 260002), which was amended shortly thereafter. The Truk State Attorney and Finance Officer approved the contracts and

certified fund availability. The estimated and approved costs for materials and labor were based on estimates used in the Water Resources Contract. Performance by both parties under the contract was hampered because of equipment breakdown, the inability of Truk State to obtain easements, and difficulties in drilling conditions.

Truk State asked the Joint Venture to provide substituted performance in the form of installation of electrical distribution lines in the Summer of 1982. In accordance with the requirements of the Trust Territory, Truk State obtained approval for the substitution from the U.S. Navy Officer in Charge of Construction, who set out certain guidelines. The Joint Venture was to obtain the original contract price for the substituted performance. The contract price was increased slightly as a result of the Joint Venture's having to correct an error by Truk State in ordering improper materials that had to be modified. Once the substituted performance was completed, the parties mutually cancelled the Well Drilling Contract. The trial court on remand found that Truk State's concern over its alleged liability for delay damages and payment of extended overhead contributed to its request and agreement that the contract be mutually terminated, with the Joint Venture accepting full payment on the contract in lieu of any damage claim.

Respondent MDCI entered into numerous other capital improvement contracts with Truk State, and took over three contracts initially given to Joint Venture, which dissolved in December of 1982. The State Attorney and Finance Officer approved all of these contracts. Before the appellants obtained their injunction prohibiting Truk State from paying private contractors, MDCI had performed, the trial court found, \$392,422.12 worth of work for which MDCI has not been paid.

*Issues Presented on Appeal:*

1. Whether the Trial Court Erred in Excluding Truk State from Active Participation on Trial while Holding Truk State Liable for Quantum Meruit.

2. Whether the Trial Court Erroneously Shifted the Burden to Appellants to Establish that Respondents Had Not Entered into the Contracts in Good Faith.

3. Whether the Trial Court Erred in Finding the Water Resources Contract Was Not Tainted by Fraud.

4. Whether the Trial Court Erred in Finding that the Respondents Entered into the Well Drilling Contract in Good Faith.

5. Whether the Trial Court Erred in Striking Pages 337 and 338 of the Deposition of Charles Boddy.

6. Whether the Trial Court Erred in Finding that Respondents Entered into the Subsequent Capital Improvements Contracts in Good Faith.

7. Whether the Trial Court Erred in Finding that Truk State is Liable to Respondents on Grounds of Unjust Enrichment.

8. Whether the Trial Court Erred in Using the Contract Price as the Measure of Recovery.

*Discussion:*

A. Whether the Trial Court Erred in Excluding Truk State from Active Participation at the Trial on Remand.

The sole independent contention of intervenor/appellant Truk State is that it was improper for the trial court to exclude Truk State as a party to the action and yet hold it liable to the respondents for \$392,442.12.

Appellants brought this suit under Section 10 of the Financial Management Act which provides in part:

A cause of action shall exist in favor of the state for the recovery or preservation of funds expended or in danger of being expended



in violation of this act. The State Attorney General, or any citizen of the Federated States of Micronesia and residents of the state acting on behalf of the state as private attorney general, may proceed in state court for recovery of sums lost or in danger of being lost to their lawfully dedicated purpose . . . .

At the time of the first trial, Governor Aten and Patrick Mackenzie were officials on Truk, and as defendants their interests were opposed to those of appellants. At the time of the remand trial, a new governor and officials had been installed whose interests more closely approximated those of appellants. Therefore at the beginning of the remand trial, Mr. Paul Ake, Attorney General of Truk, sought to actively participate in the trial. The trial court denied this request because the "Truk State government, a legal entity, was never named a party to this suit."

The trial court stated that as the appellants had brought the suit in the name of the State of Truk as private attorneys general, "it was obvious that the interests of Truk State were being served with competence by plaintiffs' counsel."

Intervenor-appellant, Truk State, originally contended in this appeal that excluding Truk State violated due process of law, and deprived Truk State of the right to counsel of its choice.

At the time of oral argument, counsel for the State of Truk orally withdrew its appeal and stipulated in open court that the interests of Truk State were adequately and competently being represented by appellant's counsel. In addition, counsel for Truk State orally stated in open court at the hearing on appeal that the State of Truk would agree to be bound by any decision rendered herein including an award against Truk State for a monetary judgment. This court does not interpret Section 10 of the Financial Management Act as broadly as counsel for the State of Truk has stipulated to but this court will in this case accept the

said stipulation. The question of imposing affirmative relief on the State whenever a citizen brings an action on behalf of the State as private attorney general will be left for another court in the future.

B. Whether the Trial Court's Factual Findings on Remand Were Erroneous.

Appellants contend that the trial court made numerous erroneous factual findings, including findings that: (1) the Water Resources Contract was not affected by fraud or collusion; (2) the respondents entered into the Well Drilling Contract in good faith; and (3) the respondents entered into the subsequent capital improvement contracts in good faith.

[1-4] 6 TTC Section 355(2) is identical to Fed. R. Civ. P. Rule 52(a), and states that "findings of fact of the Trial Division of the High Court in cases tried by it shall not be set aside by the Appellate Division of that court unless clearly erroneous." The Supreme Court has recently commented extensively on the "clearly erroneous" standard in *Anderson v. City of Bessemer*, 105 S. Ct. 1504 (1985). A finding is clearly erroneous when, although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed. The appellate court does not reweigh facts *de novo*. If the district court's account of the evidence is plausible in light of the record viewed in its entirety, the court of appeals may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently. Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous. *Id.* at 1511. Rule 52 requires even greater deference to the trial court's findings when the findings are based on the credibility of witnesses. *Id.* at 1512.

### 1. The Water Resources Contract.

Respondents did not recover quantum meruit damages under this first contract, as it was cancelled and no money was ever paid. Appellants' position is that this contract was tainted by fraud and collusion, which is evidence the respondents entered into all other subsequent contracts in bad faith, so that they may not recover upon quantum meruit on those or any contracts.

In paragraph 28 of the Remand Judgment, the court found that with respect to the Water Resources Contract, the costs were not padded, no kickback sums were paid to the government officials Boddy and Baker, and that the respondents would not be held responsible for the fraudulent scheme as the scheme had initially been advanced by the government officials.

In arguing that the trial court's findings were clearly erroneous, appellants point to significant evidence in the record surrounding the fraudulent scheme. Baker testified that he and Boddy discussed working together to receive kickbacks on government projects in general in August of 1981 and that they would receive money by increasing the costs of government contracts.

Crisostomo, Williamson, Baker and Boddy all admit that they conspired in a kickback scheme related to the Water Resources Contract. Baker testified that the kickbacks would be based on padded contract prices. Williamson testified that the plan was to pay Boddy and Baker \$282,000. The tape recording of part of the September 25, 1981 meeting between the alleged conspirators reflects willing participation by the contractors, and shows how the contractors would pay the government officials in advance of project completion according to a 10% formula.

Respondents counter appellants' position by referring to extensive evidence that no prices were padded by virtue of

the kickback scheme, and that no kickbacks were ever paid under any contract.

Williamson testified that Truk State chose to do business with the Joint Venture because the Joint Venture was engaged in numerous similar projects and had done similar work for Maeda Construction. Williamson prepared the estimated cost for the contract in June and July of 1981, basing his prices on prices contained in contracts performed for Maeda, and in catalogs from construction industry associations. Williamson submitted the estimate with supporting documentation to Truk State in late July or early August, 1981. Williamson testified that the majority of discussions about the contract were conducted directly with former Governor Aten.

Former Governor Aten testified that he received the estimate in early August, 1981. He reviewed the estimate with both the Acting Trust Territory High Commissioner and the U.S. Navy Officer in Charge of Construction ("OICC"), and they compared the estimate to an estimate from a Hawaiian firm on the same project, submitted months earlier, which was substantially higher. As evidence of proper scrutiny, Governor Aten testified that the Joint Venture was specifically required to justify certain prices to the Navy OICC.

Williamson and Crisostomo testified that under the kickback scheme, payment to the government officials was to come out of the respondents earnings as limited by the contract, and not from an additional padded 10% of costs.

Respondents contend that the above evidence shows that the estimate was prepared *before* the kickback scheme was entered into, so that the conspiracy could not have been the source of padded costs. The above evidence of price comparisons also establishes that the costs were not padded. Hence the trial court was not clearly erroneous in finding that the costs were not padded.

Moreover, all participants in the kickback scheme testified that no kickback money was ever paid under the Water Resources Contract because the contract was cancelled soon after the contract was executed, when the Trust Territory refused to advance the funding. Baker testified that he never received kickback money on any contract and no evidence was presented by appellants that any kickback monies were ever paid on any contract.

[5] The trial court found that Williamson was a credible witness, and more credible than Baker. The evidence Williamson and Governor Aten supplied support the trial court's finding that there was no fraud or collusion that affected this contract, inasmuch as no kickbacks were actually paid, and no prices were padded. It does appear that any fraud or collusion may have occurred *after* the cost estimate was prepared, and that there was no fraud which caused padded prices. This was a permissible view of the evidence, and the trial court's choice of this view is therefore not clearly erroneous.

On the other hand, the scheme was certainly in effect *before* this contract was actually executed on October 2, 1981.

## 2. The Well Drilling Contract.

Appellants point to significant evidence in the record that the kickback scheme and price padding were continued into the Well Drilling Contract, CT. 260002. Also, they identify evidence of blatant mishandling of contract administration as further proof of bad faith. Given the evidence, appellants contend that the trial court was clearly erroneous in finding that the respondents entered into the Well Drilling Contract in good faith.

### (a) Evidence of Continuance of the Scheme/Bad Faith.

In paragraph 19 of the Judgment, the trial court found that the Well Drilling Contract was entirely separate from

the Water Resources Contract, and found that the kickback scheme was not continued, given Baker's testimony to that effect and the absence of the evidence that it was continued.

Appellants argue that the Well Drilling Contract was not separate from the Water Resources Contract. Even the trial court acknowledged that the costs for line items in the second contract were drawn from the first. When Boddy notified defendants that the Well Drilling Contract superceded the old contract, he told them that three separate contracts would be awarded, upon the same conditions as the former contract and the Joint Venture invoices on the Well Drilling Contract used the contract number for the former contract.

Appellants contend that Baker's testimony evidences an overreaching scheme touching all contracts. Baker testified that the scheme he and Boddy devised in August of 1981 was to be paid kickbacks out of padded contract prices. Baker testified that Williamson had offered him bribes as early as 1980 and 1981, and informed Baker that he would reward Baker for contracts Baker "let" to Williamson.

Baker testified that the prices were padded in the original contract. Nothing in the taped conversation of September 25, 1981 suggests otherwise. The fact that padded prices were carried over from one contract to the next is persuasive evidence of a continuing scheme. Also, the taped conversation tends to show that respondents would pay the government officials out of cash flow the respondents received up front, rather than out of final contract payments. Appellants contend that obtaining payments up front constituted one facet of the scheme. Most important, Baker testified that *after* the Well Drilling Contract was executed, he told respondents about the tape and that he wanted to end the kickback scheme, but Williamson said that Baker could "come back in" at any time.

Appellants point to evidence of price padding and overcharges, which appellants contend tends to show the continuation of the scheme, and which establishes, by itself, that respondents did not enter into the Well Drilling Contract in good faith.

Price Padding. After termination of the Well Drilling Contract, the Trust Territory High Commissioner requested that the office of the Inspector General of the U.S. Department of the Interior audit the procurement and administration of the Well Drilling Contract. The audit reflected that certain line items were overstated by \$60,000. In addition, Truk paid a full contract price of \$360,000 when \$66,000 worth of work had not been completed. The auditor stated that it appeared that the value of the work was less than the amount paid. Governor Aten signed a document related to the audit in which he agreed to sue to recover the \$66,000. The auditor pointed out that two of the four change orders should have decreased the contract price, but no decrease was implemented, while two other change orders resulted in an increase in the contract price.

The 9500 Electrical Distribution Line Overcharge. The original well drilling contract for 14 wells was modified when it appeared that Truk State could not get the required easements and other problems arose. Five wells were completed. Truk State sought to substitute the installation of a 9500 foot electrical distribution line for the original contract's call for procurement of wells and related equipment. The respondents own exhibit shows that the substituted performance cost was \$122,300, while the original performance would have cost \$147,503. Yet Truk State paid respondents the original contract price. Appellants contend that this establishes that respondents were overpaid for their work.

Respondent Williamson provided several explanations for the "overpayment." He testified that the additional \$25,000

was necessary to bring the line up to Navy standards. One witness testified however, that the line already met Navy standards. Williamson testified that Truk State agreed to pay the original contract price in exchange for respondents' agreement not to sue for damages resulting from delays in performance (60 days) caused by Truk State. Appellants contend that evidence shows that there was no 60 day delay. Exhibit 33 shows that respondents claimed the contract was completed by May 21, 1982, though exhibit 41 reflects the contract was "terminated" in November of 1982.

The Well Screen Modification Overcharge. One change order granted the respondents an additional \$12,500 for new well screens, which were never purchased. The existing screens were modified. Williamson set out the labor and material costs associated with the modification, justifying the additional charge, but appellants point to contradicting testimony that far less was spent.

(b) Additional Evidence of Bad Faith.

According to the audit and the testimony of the auditor, Mr. Caton, Truk State procured and administered the contract in a very suspect manner. No performance/cost analysis was ever conducted. There was no competitive bidding, and no negotiation of contract prices. There was no evaluation of progress of the work or of the completed work. Progress payments were made before work was done, and final payment was made before work was completed. The auditor referred the matter to the Department of the Interior for a fraud investigation.

An example of suspect administration is payment before performance. The trial exhibits make clear that final payment for the contract was demanded May 31, 1981 when the respondents said the contract was complete, and that final payment was made on July 20, 1981. Yet the contract was not "terminated" until November 26, 1981. Another



example of suspect administration is absence of inspection. Mr. Bossy, Supervisor of Construction of DPW, testified that he was threatened into signing the final payment application and that he was prevented from inspecting the project, which is more evidence of bad faith in the administration of the contract.

(c) Respondents' Position at Trial.

Respondents' evidence at trial undermined the auditor and the audit, and showed that prices were not padded and that the well drilling contract was administered in good faith.

Respondents produced evidence that the prices were not padded. Exhibit Q is a "final job cost" prepared by contractors at the conclusion of projects. It reflects all the expenditures of the Joint Venture, and is supported by purchase orders, invoices, cancelled checks, time sheets and vouchers which were made available at trial. The markups on materials and labor were standard in the industry. Appellants have produced no evidence to impeach Exhibit Q, and Exhibit Q establishes there was no padding.

Respondents established that the auditor was not qualified to perform price estimates. Mr. Caton, the preparer of the auditor's report, testified that he was not an expert in construction or in the evaluation of construction related costs. He recommended that someone else evaluate the fair market value of the work done, but this never took place. Mr. Caton testified that the purpose of the audit was to test the State of Truk's *procurement procedures* and not to determine the value of services rendered. When he concluded that the State of Truk was required to spend \$60,000 more for items than the cost of those items to defendants, he did so in the context of finding that Truk should do cost pricing analysis before entering into contracts. He expressly did not find that the \$60,000 was padded.

Respondents on appeal contend that the auditor's report was established to be deficient at trial because it merely compared the contract price of line items with the actual costs to the respondents. Exhibit Q demonstrated that the respondents experienced cost overruns such that Truk State received more performance than it paid for, which more than balanced instances where respondents charged the State of Truk more for work than the cost to respondents.

In addition, Williamson's testimony explained discrepancies in the audit. For example, while \$4000 was charged for vehicle modification of a used vehicle when no modification took place, the reason was that respondents at Truk's request bought a new vehicle not requiring modification at significant increased cost to the contractors.

Also, respondents argue that they did not receive a bonus \$25,000 on the contract when they received the full \$147,000 contract price for substituted performance which cost \$122,000. Respondents introduced evidence that in negotiations concerning substituted performance, the Navy OICC and High Commissioner imposed new conditions on defendants, including assumption of all cost overruns, and the waiving of any claims against Truk State for the conduct of Truk State which enhanced respondents' expenditures. In exchange, respondents were to receive the original contract price. The conditions and expenses were not reflected in the audit. Other items were explained by changed conditions which increased costs, such as the cost respondents incurred in modifying the well screening after Truk State caused them to order the wrong type.

Finally, evidence at trial established that inspections of work performed had in fact taken place. Governor Aten and Rex Ressoreccion testified that USGS Water Expert Dan David inspected and approved all wells. The Resident Officer in Charge of Construction in Truk State inspected and approved the electrical distribution line upon its completion.

Hence appellants' evidence of bad faith connected to faulty contract administration was contradicted at the time of trial on remand.

Respondents point out that to the extent appellants' argument rests on the testimony of Baker, the trial court expressly found Baker to be not credible, while finding Williamson was credible.

On remand the trial court found that the kickback scheme was not continued, and that there was no evidence that government officials received monies. The trial court set out the rights and obligations of the parties under the agreement. It found that the agreement to substitute performance was entered into at arms length, relying on testimony of Governor Aten who stated that Truk's construction consultant posited a far higher cost for the electric distribution line than Truk actually paid. The trial court found that the contractors received the full original contract price for the substituted performance as consideration for accepting certain conditions, assuming costs, and dropping claims against the State of Truk. The trial court followed the contractors' explanations of the costs, relied on exhibit Q, and found markup and labor charges to be standard in the industry. The trial court found the contractors entered into and completed this contract in good faith.

[6] The trial court's factual findings and its conclusions that the respondents entered into the Well Drilling Contract in good faith are not clearly erroneous when the entire record is examined. This court cannot conclude that a mistake has been made. The evidence relied upon by the trial court has produced a plausible interpretation which the trial court has clearly adopted. As such, this court is compelled to affirm the trial court's decision insofar as the Well Drilling Contract is concerned.

### 3. Subsequent Capital Improvement Contracts.

The trial court awarded the respondents on their counter-claims as against the State of Truk over \$392,000 in quantum meruit for work performed on contracts entered into between the Joint Venture or MDCI and Truk. The trial court found that the money was completely unrelated to the Water Resources Contract or the Well Drilling Contract. The trial court specifically found the contractors were entitled to the money claimed, as they entered into the contracts in good faith. Appellants contend that the trial court misapplied the Appellate Division's allocation of the burden of proof and definition of good faith, which were errors of law. Appellants also contend the court erred as a factual matter.

#### (a) Quantum Meruit/Definition of Good Faith/Burden of Proof.

In the Appellate Opinion of November 17, 1986 at pages 24–25, the Appellate Division provided guidance to the trial court on remand.

The Appellate Division adopted a general rule set out in *Luzerne Township v. Fayette County*, 330 Penn. 247, 249, 199 A. 327, 329 (1938) that when municipalities accept the services of a contractor under an invalid contract, the contractor is entitled to recover on a theory of quantum meruit. The Appellate Division also held that where the contractor acted in *bad faith* or procured the subject contract by *fraud or collusion*, the contractor is entitled to nothing, relying on *Miller v. McKinnon*, 124 P.2d 34 (Cal. 1942).

*Miller* also held that contractors are presumed to know the law of contracting, and if they act in contravention of the law, they do so at their peril. The Appellate Division expressly rejected this element of *Miller* in its *opinion*, and held that contractors may only be barred from recovery

upon a showing of lack of good faith. Appellate Division Opinion at 25. This produces the anomalous result that a contractor is not necessarily acting in bad faith when he enters into a contract which he is presumed to know is invalid.

However, in the Appellate Division's remand *order* the Appellate Division stated that "good faith shall include overcoming the presumption of knowledge of the requirements of government contracting set forth in the Truk Charter and all succeeding legislative acts in force at the time the contracts were entered into." This order means that contractors are presumed to know not only the law of contracting procedures but all Truk State laws affecting the ability of Truk State to contract.

The Appellate Division, in its prior decision, held that to establish good faith it must be shown that there was a lack of bad faith. The Appellate Division did not specifically define "good faith."

The Appellate Division squarely placed the burden on *respondents* including private contractors to show that the contracts in question were entered into in good faith.

In short, the Appellate Division required respondents to prove that they did not act in bad faith. Evidence that they entered into invalid contracts alone does not establish bad faith according to the previous Appellate Division Opinion.

On Page 27 of the Judgment on Remand, the trial court set out the Appellate Division's guidelines, but also cited *Gamewell Company v. City of Phoenix*, 21 F.2d 928, *modified* 219 F.2d 180 (9th Cir. 1955). In *Gamewell* the court permitted a contractor to recover in quantum meruit from a city on an invalid contract because there had been no showing of bad faith. The Ninth Circuit, applying Arizona law, resolved that there *need not be positive proof or express findings of good faith* (emphasis added) before a court may grant recovery. 219 F.2d at 181. The appellate court upheld

the trial court's grant of a right to recover because the record did not disclose any bad faith on the part of city officials in awarding the contract at hand, and the city's counterclaim made no allegations of bad faith. *Id.* at 182.

The *Gamewell* court did not expressly allocate the burden of proof on the good faith issue. However, it did hold that no positive evidence of good faith was required. Logically if there were a burden to establish good faith, it would fall upon the contractor seeking to recover in quantum meruit. Arguably by not requiring positive proof of good faith, which the court in *Gamewell* defined as the absence of bad faith, *Gamewell* placed the burden on the municipality to produce evidence of the contractor's bad faith. This allocation of burden in the instant case would conflict with the Appellate Division's allocation here. Therefore this court must examine the evidence and reasoning of the trial division here to determine whether it in fact erroneously shifted the burden to appellants.

(b) Evidence of Fraud or Collusion in the Capital Improvements Contracts.

Appellants reiterate their laundry list of sinister acts in their brief. They refer to the evidence of the kickback scheme. They also point out that government official Boddy entered into a joint venture agreement with respondent Crisostomo for construction at Rota airport in February 1983 and thereafter signed numerous contracts here in dispute for the benefit of his new business partner Crisostomo. Hence appellants contend, bargaining for contracts actually took place between business partners.

Appellants also rely heavily on the testimony of Balthazar Bossy, Supervisor of Construction who testified that he did not inspect eight of the key projects in question, though defendants witness Diaz testified that Bossy did inspect them. Bossy stated he did not inspect because he had been threatened by Boddy and because the Joint Venture did not

provide him with documents. If Bossy's testimony was credited by the trial judge it would establish fraud in the administration of the contracts.

In their brief, respondents do not present additional evidence of good faith or absence of bad faith in entering into the agreements.

The trial court found that all of the capital improvements contracts had been entered into in good faith. The trial court found in addressing the above evidence that there was no evidence before the court that the joint venture between Boddy and Crisostomo had any effect upon the capital improvements contracts or on contracting with Truk State generally. The trial court completely discredited the testimony of Bossy. It found that Bossy may not have inspected sites for his own reasons, that Bossy did not know whether or not other DPW inspectors had inspected the sites, that Bossy never told anyone including relatives about Boddy's threat, and that Boddy did not review documents because he did not ask for them from the Joint Venture.

In addition, the trial court in finding good faith, accepted the testimony of respondent's witness Diaz, and Mel Morris, the new Director of Public Works, who inspected all the sites. Diaz testified that all the projects were completed to the extent of invoices submitted, and testified as to the fair value of the work done. Morris stated the work was above average, that the contract prices were reasonable, and that Truk State received the reasonable value of the work performed. Governor Aten testified that he negotiated all the contracts in good faith.

(c) Evidence of Respondents' Knowledge of the Legal Status of the Contracts.

The Appellate Division previously found the contracts violated several laws. They violated the Truk Charter which required appropriations for all money withdrawn from the

treasury, and required that appropriations not exceed available revenues. (Truk Charter Sec. 219, 220.) They violated the Truk State Financial Management Act which only permits Truk State to obligate money after appropriations have been made and the funds are available. (FMA secs. 5(1), 6(2).) Those executed after the effective date of December 14, 1982 violated the State Budget Act which prohibits the expenditure of state funds absent an appropriation or a legislative budget bill. Finally, they may have violated the Public Service System Act which only allows Truk State to give construction projects to private contractors once the personnel director of the DPW issues a certificate exempting them from allocation to the DPW. The Appellate Division required Aten to provide certificates for the 31 contracts at issue.

However, there was no law effective in Truk State at the time the contracts were entered into requiring Truk State to give out contracts by advertisement (bidding), and negotiated contracts were permissible. The parties concede this.

The trial court made the summary factual finding that all of the capital improvement contracts were approved by the State Attorney, and the State Finance Officer certified that funds were available. The trial court accepted Governor Aten's testimony that the contracts were negotiated in good faith. The trial court found that all of the capital improvement contracts were permissible under Truk State law, even though negotiated rather than advertised. All the agreements were approved as to form by the State Attorney, and so the Joint Venture was reasonable in assuming that the contracts were legal and proper. As a matter of law, the trial court then concluded that the Joint Venture negotiated and entered into the contracts in good faith because it believed the contracts met all of the legal requirements.



The trial court also concluded that "the third party defendants overcame the presumption of knowledge of Truk State government's contracting requirements in that they entered into negotiated contracts with Truk State, knowing that negotiated contracts, as contrasted with contracts by advertisement, were proper and legal at the time the contracts were entered into."

Appellants point out that there is no evidence in the record whatsoever to support the trial court's finding that respondents relied on the words or acts of the State Attorney.

Appellants point to evidence which would establish that respondents including the private contractors were on notice that the contracts were illegal for violating the Truk Budget and Finance laws. The Director of Finance certified funding on numerous projects for only fractions of the contract amounts. There was no evidence that the legislature appropriated funds for the contracts. Hence, appellants assert that respondents, including the private contractors did not and could not meet their burden of showing they acted in good faith.

Respondents do not cite any evidence in the record on this issue. They state that the trial court reached its ruling because there was no credible evidence of bad faith on the part of respondents, and because it lent credence to all the evidence propounded by respondents. Also, the trial court found good faith because the method by which respondents entered into contracts through negotiation with the Governor was permissible at the time. Hence, even if they were presumed to have knowledge of the law, they would not have acted differently.

(d) Good Faith Versus Bad Faith.

[7] The trial court made the burden of the respondents to show good faith an easy burden to establish. Given that

respondents point to no specific evidence showing that they acted in good faith, that they were unaware of the laws that were in fact violated, or that they relied on the approval of the State Attorney, and given the trial court's reference to *Gamewell*, in which the trial court held that no affirmative evidence of good faith is required, this court could well conclude that the trial court erroneously shifted the burden to appellants to prove bad faith.

This Appellate Division has previously found that the contracts actually violated several laws and were invalid. According to the remand order, to recover on quantum meruit, respondents had to overcome a presumption that they were aware of the effect of these laws. There is no evidence in the record which overcomes that presumption. The trial court concluded as a matter of law that respondents overcame the presumption of knowledge of the State of Truk's contracting requirements because they knew at the time they entered the agreements by negotiation that such a procedure was legal. This conclusion does not address the Appellate Division's concern for violation of other laws, or its specific instructions. This court concludes that the trial court examined and ruled upon the wrong legal problem, and that respondents did not overcome the presumption that they knew the relevant Truk State laws and that the contracts were illegal under them.

If evidence of bad faith is limited to evidence of actual fraud and collusion, there is evidence supporting the trial court's finding that respondents negotiated agreements, as was permitted, and that the resulting contracts were fair, and carried out. The trial court dismissed the credibility of the witnesses supplying contrary information and was unwilling to draw sinister inferences.

[8] The trial court's finding that respondents entered into the capital improvement contract in good faith was erroneous.

C. Whether the Trial Court Erred in Excluding Pages 337 and 338 of the Deposition of Charles Boddy.

At the initial trial the trial court excluded the entire deposition of Charles Boddy. The Appellate Division noted that the admissibility of a deposition is within the sound discretion of the trial court and the trial court's ruling should not be overturned absent a showing of abuse of discretion. However as the Boddy deposition forms the crux of appellants' case in that it reveals the kickback scheme, the Appellate Division remanded the issue to the trial court, instructing it to review the deposition *in camera* to determine which parts are relevant and reliable.

The trial court admitted the deposition at the trial on remand, but on the last day of the trial granted respondents' motion to strike pages 337 and 338 from the record on the grounds of irrelevance, ruling that nothing in those pages reflected a confession of wrongdoing on the part of Boddy.

The Boddy deposition concerned the September 25, 1981 meeting at which the kickback scheme was discussed. The pages in question here demonstrate that a scheme existed under which each of the participants would receive \$141,000. They also demonstrate that Governor Aten was involved in scheming with Williamson to cover up a transaction involving "engines" with the issuance of checks that would never be cashed so that the Governor would be protected in the event of an audit.

[9] Appellants correctly assert that the testimony is relevant not only to proving the kickback scheme, but also to undermining the credibility of Williamson and Governor Aten whose testimony formed the basis for the trial court's judgment. The pages should have been admitted. This was an abuse of discretion. However, there is no showing that these pages would have affected the trial court's ruling, so that reversible error does not exist.

D. Whether the Trial Court Used the Correct Measure of Damages.

In its opinion, the Appellate Division held that if respondents acted in good faith, they would be entitled to recovery in *quantum meruit*, relying on *Luzerne Township v. Fayette County*, 199 A. 327 (Penn. 1938). (Contractor entitled to quantum meruit from municipality which received benefit of contractor's services under invalid contract.)

[10] As Judge Hauk noted in *Fontaine v. Home Box Office*, 654 F. Supp. 298 (C.D. Cal. 1986), quantum meruit is an equitable doctrine based on the concept that no one who benefits by the services or goods provided by another should be unjustly enriched thereby. Under such circumstances, the law implies a promise to pay a reasonable amount for the services or goods furnished, even absent a specific contract therefor. *Id.* at 303. California courts permit the provider of goods or services to receive the reasonable value of the benefits conferred. *Beley v. Municipal Court*, 100 Cal. App. 3d 5, 8; 160 Cal. Rptr. 508, 509 (1979) (contractor entitled to receive reasonable value of home improvements conferred on buyer).

The Appellate Division relied on Pennsylvania law in *Luzerne*. The Pennsylvania Supreme Court expressly upheld *Luzerne's* rule of municipal liability on quasi-contract in *J. A. & W. Hess, Inc. v. Hazle Township*, 400 A.2d 1277 (1979). The court also noted that the remedy may not be available if (1) the municipality has acted *ultra vires* in entering the invalid contract; (2) the benefit was not conferred on the municipality but on a private person; (3) the contractor and not the municipality assumed the risk under the contract for unanticipated work; or (4) subterfuge was present and was obvious to both the contractor and the municipality. *Id.* at 1279, *see also Township of Ridley v. Pipe Maintenance Service Inc.*, 477 A.2d 610 (Penn. 1984).

In the latter case, the court noted that recovery on quasi-contract is not limited to the original contract price where the reasonable value of goods and services accepted by the municipality exceeds that price. *Id.* at 613. Other courts have held that quasi-contractual recovery may not exceed the contract price. *See Capitol Bridge Co. v. County of Saunders*, 83 N.W.2d 18 (Neb. 1957).

The cases do not make clear how the reasonable value of goods and services is to be determined. Respondents here argue that they may include reasonable profits, citing a case awarding reasonable attorney fees. *Sluder v. San Antonio*, 2 S.W.2d 841 (Tex. 1921). In New York, "the value of actual services rendered and materials supplied *less profits* have been held to be recoverable on a quantum meruit basis, limited by the contract price." *Goldman v. Garofalo*, 409 N.Y.S.2d 684, 688 (1978). Some courts only permit a supplier of goods and services to receive the value to the recipient of the benefit received, rather than the cost to the supplier of providing the benefit. *Hill v. Waxberg*, 237 F.2d 936 (9th Cir. 1956).

In its previous opinion, the Appellate Division did not define quantum meruit. It did not specify whether quantum meruit was limited to the value of the benefit conferred, or whether it should relate to the reasonable value of the goods and services, which appears to be a majority rule. It did not specify whether reasonable value may include reasonable profit. In its remand order on page 5, according to appellants, the Appellate Division placed on respondents the burden of establishing the "fair dollar value of the benefits received." It is not completely clear that the Appellate Division intentionally rejected the "reasonable value of services" measure.

The trial court, in citing *Annotation: Municipality—Quasi-Contract Liability*, 33 A.L.R.3d 1223 sec. 17 at page

32 of its opinion clearly adopted a “reasonable value of the services” measure. (Jt. p. 32.)

Appellants point out that respondents never produced any evidence of the value of the services and labor actually rendered for the benefit of Truk State, but only offered evidence that the contract prices were reasonable. The contract prices included overhead and profit. Appellants also go to great length to show that Truk State did not benefit from respondents’ work either because the projects were not completed, or because respondents retained control of the materials they purchased for Truk State.

It is clear that respondents did not meet the burden imposed by the Appellate Division to show the fair dollar value of the services and materials supplied.

It is also clear that the trial court did not apply a quasi-contractual measure of recovery, but rather awarded contract prices, which included profit and overhead. In Paragraph 41 of its Judgment on Remand, the court states that MDCI claims \$392,422.12 under the capital improvement contracts. In Paragraph 43 of its Judgment on Remand, the trial court states it received evidence from one witness as to the reasonable value of services rendered, and evidence from other witnesses that the *contract prices* were reasonable. In Paragraph 46 of its Judgment on Remand, the court found that all *contracts* were reasonably priced. In Paragraph 51 of its Judgment on Remand, the trial court measured damages solely by looking to the unpaid balances on invoices submitted for the projects. This only has a tenuous relationship to the actual value of services rendered and benefits received. Finally, in its Conclusion of Law No. 15, the trial court held respondents were entitled to the full amount of balances due on completed contracts, and a “reasonable amount” for contracts not completed as a result of the injunction issued by the trial court originally.

[11] This court therefore reverses the trial court's findings with regard to respondents quasi-contractual recovery on the theory of *quantum meruit* recovery with specific instructions to the trial court to conduct an evidentiary hearing to establish *quantum meruit* on the basis of the reasonable value of the goods and services rendered by respondents to the State of Truk and the benefit conferred on the State of Truk. In no event should the trial court find that *quantum meruit* exceeds the contract price for any specific contract entered into.

E. Whether Quasi-Contractual Recovery is Barred on the Ground that the Government Officials Acted Ultra Vires when They Let Out Contracts in Violation of Truk State Law.

Some courts have formulated a rule that quasi-contractual recovery will not be awarded at all if the municipal entity was acting *ultra vires* when it gave out a public contract. Appellants cite *Hudson City Contracting Co. v. Jersey City Incinerator Authority*, 111 A.2d 385 (N.J. 1955):

In summary, we find that the New Jersey law pertinent to this type of case is that where the contract was not within the corporate power no recovery may be had by the contractor either on express or implied contract; where the Legislature expressly prohibits the incurring of liability on contract or otherwise no recovery may be had either on express or implied contract, but where the power to contract lies within the competence of the municipal corporation and there has been an irregular exercise of that power in good faith, recovery on *quantum meruit* may be had although the express contract is void. *Id.* at 391.

Pennsylvania has a similar rule, noted in *Township of Ridley, supra*.

In this case, the Appellate Division in its opinion previously found, as a matter of law, that former Governor Aten was acting *ultra vires* when he let out the contracts.

It found that the contracts violated several laws, and specifically noted:

The Charter requires appropriations for all money withdrawn from the Treasury. Truk District Charter sec. 220. No obligation can be incurred except as authorized by law. *Id.* Section 219 prohibits appropriations in excess of available revenues. The evidence indicates that former Governor Aten entered into contracts on a whim, regardless of appropriations or available funds. This practice is prohibited by the Charter. The result of this practice was several million dollar deficit.

As a result, appellants urge this court for the first time on the second appeal to reverse the judgment and enter judgment for appellants for all monies paid out.

Respondent argues, correctly, that this is not the law of the case as specifically set out by the Appellate Division in its former ruling. The Appellate Division did not consider the *ultra vires* argument, and ruled that respondents could recover if they acted in good faith. This court will not reverse its own law.

#### CONCLUSION

For the reasons contained herein, we affirm in part, reverse in part, and remand to the trial court for findings consistent with this opinion.