

HB

235

ALASKA STATE LEGISLATURE

HOUSE JUDICIARY COMMITTEE

Representative Norman Rokeberg, Chairman
Representative Scott Ogan, Vice-Chairman
Representative John Coghill
Representative Jeannette James
Representative Kevin Meyer
Representative Ethan Berkowitz
Representative Albert Kookesh



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Heather M. Nobrega
Counsel to Committee

Sponsor Statement for HB 235

This legislation has been introduced at the request of the Associated General Contractors of Alaska.

Public works construction contracts contain "changes" clauses that provide a vehicle for contract adjustment in the event the contractor encounters changed conditions or the public works' owner desires to change the contract in some manner. Claims may arise regarding compensation for the change orders or regarding whether or not particular work was included in the bid documents at bid time.

This legislation would simply require that when a contract settlement with DOTPF is in dispute, and settled in favor of the contractor, interest must be paid to the contractor on the settlement amount from the date of the claim to the date of the decision.

The committee urges your support of this bill.

DEPARTMENT OF LAW
OFFICE OF THE ATTORNEY GENERAL

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April 16, 2001

The Hon. Vic Kohring, Chair,
and Members, House Transportation Committee
State Capitol, Room 24
Juneau, AK 99801

Re: HB 235 – An Act relating to the handling of and interest on contract controversies involving the Department of Transportation and Public Facilities or state agencies to whom the Department of Transportation and Public Facilities delegates the responsibility for handling the controversies.

Dear Representative Kohring,

I am the attorney assigned by the Alaska Department of Law to provide testimony on HB 235, which provides for prejudgment interest on administrative claims. Due to litigation demands in another case, I am in Ketchikan today and unable to testify. As a consequence, I respectfully submit this letter in place of in-person testimony. If any committee member has questions regarding the contents of this letter, I would be happy to meet with that member in person, or respond in writing to the entire committee. I can be reached by phone at 465-6712, and by fax at 465-6735.

• **Prejudgment Interest on Administrative Claims Not Allowed in Majority of Other States**

We have not undertaken a survey of every state in the country. However it appears that a fair number of states do not pay prejudgment interest on administrative contract claims either outright or because the law in those states limits payment of interest to “liquidated” claims, i.e., claims that are capable of calculation under some contractual formula that does not require the exercise of discretion by agency personnel.

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Alaska law, AS 36.90.200(a), already requires payment of interest on "payment requests" for work satisfactorily performed on state construction projects. If the state gives notice to the contractor that the work covered under the payment request is unsatisfactory, no interest is paid on that payment request until 21 days after the unsatisfactory work is corrected. AS 36.90.200(e). While this statute does not cover payment of interest on contract claims filed under the State Procurement Code, it is an example of the type of "liquidated" amount on which interest would ordinarily be paid if timely payment were not made by the state.

Where contract claims are concerned, there may be good policy reasons to withhold the payment of prejudgment interest. There may be policy reasons why the agency should have the opportunity to examine such claims before prejudgment interest begins accruing.

- **Cost of Application of HB 235 to Construction Contracts**

Under the Alaska Procurement Code, the Alaska Department of Transportation has the procurement authority for all construction projects conducted in the state. AS 36.30.005(b). The Department of Transportation may delegate that authority to other agencies under AS 36.30.632. Therefore, since all construction is either being performed by DOT&PF or by other agencies under delegation of authority by DOT&PF, prejudgment interest will affect all agencies conducting construction that are either subject to AS 36.30 or that are required to have similar procurement procedures.

The costs to the state for prejudgment interest if HB 235 became law could be substantial. For example, DOT&PF estimates that annual interest indebtedness could be between \$500,000 and several million dollars if the companion bill to HB 235 (SB 152) were to become law, although federal matching money would be available to cover some of that cost. Fiscal Note 1, SB 152. On just three recent claims of which we are aware, prejudgment interest totaling approximately \$1,200,000 would have been paid by the state if prejudgment interest were due on those claims.

- **If HB 235 Becomes Law, How Will the State Pay Prejudgment Interest?**

FHWA Projects: DOT&PF does most of its construction in the State of Alaska by using funding from the Federal Highway Administration (FHWA). While the budget process for federal funding is beyond the scope of this letter, it appears that FHWA will participate in payment of interest on construction claims according to

a federal participation rate that typically is 90 percent. Of course, payment of interest on a project means that fewer dollars will be available for projects in the state. In other words, prejudgment interest paid on one project may mean that the state is unable to fund another project somewhere else in the state.

FAA Projects: DOT&PF also conducts construction activities at airports throughout the state to build new, or expand existing, facilities utilizing Federal Aviation Administration ("FAA") funding). FAA grants operate differently than those for FHWA-funded projects. In FAA projects, the amount of a grant is based on the state's total estimate of all costs to design and construct the project. Increases in the grant amount are limited to 15 percent of the original grant. Any additional costs incurred above the grant plus 15 percent must be covered entirely by the state. If interest exceeds the amount of the FAA grant, the state will have to fund all additional expenses without FAA participation.

HB 235 affects all agencies in the state that conduct construction activities under a delegation of authority from DOT&PF. Many of these projects are supported by programs that include funding and grants from federal agencies other than FHWA and FAA. As a consequence, it may be that federal participation in administrative claims is limited in certain situations, depending on the funding source, and that state funds will have to be used to pay interest claims. Because we have not undertaken a study of the way other agencies performing construction with a delegation from DOT&PF fund projects, it is unclear that federal participation will be available to fund interest payments owed as HB 235 is currently drafted.

- **Equal Protection Issues for Other AS 36.30 Claims**

There may be an equal protection problem with this legislation as presently drafted. HB 235 authorizes the payment of interest on claims under AS 36.30.620 - .630 and 36.30.670 - 36.30.685 against DOT&PF and other agencies acting under a delegation from DOT&PF. HB 235 therefore applies to DOT&PF construction claims. Contractors asserting claims against other agencies under AS 36.30.620 - .630 and 36.30.670 - .685 may allege that they are denied equal protection of the law because they are denied prejudgment interest on their claims, while DOT&PF contractors who file claims under the same statute are entitled to interest.

The state would have to demonstrate at least a legitimate state interest in allowing prejudgment interest on some claims while denying it on others. A court might conclude that the legislature's interest in limiting prejudgment interest only to

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construction claims simply to save the costs of having to pay interest on all AS 36.30 claims does not bear a substantial relationship to a legitimate state objective.¹

- **Equal Protection Issues for Non-AS 36.30 Construction Projects**

The Alaska Railroad Corporation, the Alaska Aerospace Development Corporation, and the Alaska Seafood Marketing Institute must adopt procedures "substantially equivalent" or "substantially similar" to AS 36.30. AS 36.30.015(e), AS 36.30.015(h). Claimants against these agencies may argue that, by virtue of the changes proposed to the procurement code by HB 235, these agencies also have to provide for the payment of prejudgment interest on claims.

Other agencies exempt from AS 36.30 include the University of Alaska, the Alaska Housing Finance Corporation, the Alaska State Pension Investment Board, the Alaska Court System. AS 36.30.005(c), AS 36.30.015(f), and AS 36.30.030. These agencies do not have to adopt procedures equivalent to the State Procurement Code. However, the same or a similar equal protection argument may be advanced with respect to those agencies. In the recent past, at least AHFC and the Court System have faced construction claims.

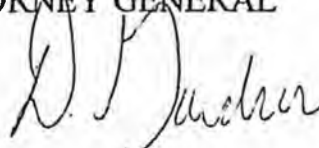
¹ The Alaska Supreme Court has held that Equal Protection Clause of the Alaska Constitution affords greater protection to individual rights than that afforded under the U.S. Constitution. *State v. Enserch Alaska Construction, Inc.*, 787 P.2d 624, 631 (Alaska 1989); *Laborers Local No. 942 v. Lampkin*, 956 P.2d 422, 429 (Alaska 1998). The court uses a sliding scale analysis that determines the relative importance of the individual right and the State interest and, depending on the importance of the individual interest, requires the State interest to "fall somewhere on a continuum from mere legitimacy to a compelling interest." *Enserch*, 787 P.2d at 631. The nexus between the State's interest and the means used by the State to achieve that interest must fall on a continuum from a "substantial relationship to [the] least restrictive means," again, depending on the importance of the individual right at issue. *Id.* at 631-32. *Williams v. State*, 895 P.2d 99, 104 (Alaska 1995); *Herricks Aero-Auto Aqua Repair v. State, DOT&PF*, 754 P.2d 1111, 1114 (Alaska 1988)(economic interests entitled to only minimal protection under Alaska Equal Protection Clause; cost savings alone may not be a legitimate state interest).

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If you or any committee member has questions regarding the testimony summarized above, please advise.

Sincerely,

BRUCE M. BOTELHO
ATTORNEY GENERAL

A handwritten signature in cursive script, appearing to read "D. Gardner", is written over the typed name of the Assistant Attorney General.

By: Doug Gardner
Assistant Attorney General

cc: Michael K. Abbot, Legislative Director, Governor's Office
Vern Jones, Chief Procurement Officer, State of Alaska
Legislative Liaisons
Deborah Behr, Legislation Attorney, Department of Law
Chrystal Smith, Legislative Liaison, Department of Law.



ASSOCIATED GENERAL CONTRACTORS of ALASKA

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TELEPHONE (907) 561-5354 • FAX (907) 562-6118

April 6, 2001

Re: SB 152 – Interest on Contract Controversies

HB 235

Dear Senator:

On public works projects in the State of Alaska, a contractor encountering a condition that requires a change in the contract, is required to perform the work even if there is a dispute as to the appropriate adjustment. Resolution of such a claim frequently takes as long as four years and the State currently disallows interest on the amount of the ultimate settlement.

Most, if not all, public works contracts include contract adjustment clauses that provide a method for adjusting the contract amount when the contractor encounters changed conditions or the owner desires to change the contract in some manner. The purpose of this clause is to assure that the contractor is fairly compensated for the extra work occasioned by the change.

Alaska courts generally recognize that awarding prejudgment interest to a plaintiff is necessary to make him "whole" by compensating him for the use of money rightfully his between the time of injury and trial. The courts have held that prejudgment interest should be denied only in the most unusual cases and place the burden of proving the unusual situation on the party opposing the award of prejudgment interest. The State of Alaska apparently believes that contractor claims in general represent an "unusual case" and therefore prejudgment interest should not be applied to these claims.

We urge you to support SB 152. This bill allows construction contract claims to be treated the same as all other claims in the State of Alaska. There is no public interest in discriminating against the entire construction industry in these matters.

Sincerely,

Richard Cattanach
Executive Director

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INTEREST ON CONTRACT CONTROVERSIES

SB 152
HB 235

Position Paper of The Associated General Contractors of Alaska

ISSUE: Given the complexity of construction projects, it is not unusual that differences sometimes develop between the owner and contractor regarding the scope of work covered in the contract. In those instances when the differences cannot be successfully resolved, the parties can avail themselves of the claims process set forth in the Alaska procurement code. One problem with this process is the inherent delay in the ultimate payment of the claim. The position of the State of Alaska is that they do not owe interest on the ultimate awards. Contractors believe that the delayed payment costs them not only foregone interest but also the costs of preparing and defending their claim, and that the avoidance of interest is not only contrary to common practice, it is bad public policy.

ADVANTAGES: For the State of Alaska, delaying claims allows them to earn interest on money they ultimately owe the contractor. Through such delays the State derives an economic interest in postponing the claims process. Another advantage enjoyed by the State accrues from its superior financial strength and legal resources, which sometimes can be used to force financially, strapped companies to settle their claims at a fraction of the claims value.

The current system offers no advantages to the contractor.

DISADVANTAGES: The primary disadvantage to the State will be derived from the addition of interest to the cost of a claim for the period the claim is being contended. The proposed law will put a premium on the expeditious settlement of construction claims. The State will have to change its procedures to handle such claims in a more timely manner.

There are no disadvantages to the contractor.

AGC POSITION

The current process regarding the settlement of a claim places the contractor at an economic disadvantage. Since the expenses underlying a claim have to be paid, the contractor incurs these costs plus the costs of preparing and defending its position. During this entire process the State is allowed to invest those funds for its own economic gain as well as using its superior resources to threaten the economic viability of the claimant. Payment of interest on claims is not only good public policy, but it is consistent with prior practices of the Department of Transportation regarding such claims. Currently the State of Alaska must pay prejudgment interest for virtually all other contract claimants. Contractors, however, have been singled out for disparate treatment.

Associated General Contractors of Alaska
Legislative Priorities
2001

Long Term Fiscal Plan - It is in the best interests of the State that the legislature and administration adopt a long-term fiscal plan that deals with the issue of falling petroleum revenues, the permanent fund, and new economic incentives. Part of this plan should include an increase in the gasoline tax and a dedication of those funds to underwrite the costs of highway maintenance.

Matching funds for transportation projects - The transportation infrastructure of Alaska is currently inadequate and requires continued planning, upgrades, and expenditures to assure the citizens of Alaska are provided with essential services. The economic benefit derived from this investment far exceeds the matching funds required to secure the federal matching funds. Accordingly the legislature is encouraged to continue providing full funding of the federal highway matching funds.

Funding for vocational/technical education - A majority of Alaska's high school graduates do not go to college yet the State's high school curriculum is oriented to college preparation. The legislature should adopt a more balanced funding approach to better prepare those students not pursuing post-secondary education for the world of work.

Pre-judgment interest on claims - Construction claims frequently represent differing opinions between the owner and the contractor regarding whether or not particular work was included in the bid documents at bid time. Since resolving these differences takes time and since the contractor incurred costs to complete the work, the contractor should be entitled to interest on the claim settlement from the time the claim was filed until payment.

Definition of design build - Design/build is a project delivery system that is widely used in private construction and is starting to gain acceptance in public construction. The Alaska procurement code does not contemplate or define design/build construction and therefore all such use by public entities is performed under the term "alternative procurement procedures". Due to the uncertainty as to the use and applicability of the design/build delivery system in the public sector, it is in the best interests of all parties that its use and definition be clearly set forth by the legislature.

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Subj: FW: Prejudgment Interest Alaska Construction Contracts
Date: 4/9/01 6:24:02 PM Pacific Daylight Time
From: mdm.mbcontracting@alaska.com (Mike Miller)
To: thyes@aol.com

---Original Message---

From: Jpalaw2@aol.com [mailto:Jpalaw2@aol.com]
Sent: Thursday, April 05, 2001 11:45 AM
To: mdm.mbcontracting@alaska.com
Subject: Prejudgment Interest Alaska Construction Contracts

Mike,

I had some time to look at the books this morning and hope this will be helpful in your testimony.

Public works construction contracts contain "changes" clauses that provide a vehicle for contract adjustment in the event the contractor encounters changed (differing site) conditions or the public works owner desires to change the contract in some manner. The basic purpose of the changes clause is to fairly compensate the contractor for the extra work occasioned by the change. That is, the clause provides for an equitable adjustment to the contractor's contract and makes the contractor whole for the extra scope (outside the basic contract scope) work performed.

Alaska courts recognize that awarding of prejudgment interest to a plaintiff is to make the plaintiff whole by compensating him for the use of money rightfully his between the time of injury and trial. *McConkey v. Hart*, 930 P.2d 402 (1996). Alaska courts also recognize that prejudgment interest should be denied only in the most unusual case; burden of proving the unusual situation is on the party opposing the award of prejudgment interest. *Hancock v. Northcutt*, 808 P.2d 251 (Alaska 1999). The purpose of awarding prejudgment interest is to compensate the successful claimant for loss of use of money between the date he/she was entitled to it and the date of judgment; the corollary purpose is to prevent the unsuccessful party from being unjustly enriched by the use of the money. *Lundgren v. Gaudiane*, 782 P.2d 285 (Alaska 1989). In contract actions the right to prejudgment interest generally arises on the date of breach. *Morris v. Morris*, 724 P.2d 527 (1986).

Applying those principals to construction changes in public works contracts, the date on which the prejudgment interest should be calculated is the date the change occurred (e.g., the date the differing site condition was discovered, the date the owner directed the contractor to change the work, the date the contractor learned that the contract specifications contained an error . . . etc.). If the purpose of the changes clause is to make the contractor whole in the event of a change, then the time value of money (prejudgment interest) should be an element of the contractor's recovery. Keep in mind that the contractor, when changes are encountered on a public works project, has no option but to perform the changed work if there is a

dispute as to the appropriate adjustment. The contractor must perform and argue about the price later. It would be inequitable if the contractor, under these circumstances, was not compensated for prejudgment interest.

I also looked at Danco Exploration v. State of Alaska, 924 P.2d (Alaska 1996). Danco appears to be the case that the Attorney General's office is relying on in denying prejudgment interest. I understand where the Attorney General is deriving its argument from, "sovereign immunity". Unless the State has, by statute, provided that the contractor can recover interest against the State, the contractor has no right against the State (you cannot sue the king unless the king allows you to sue him). Therefore, this case would seem to call for a statute, which the legislature can pass, which specifically allows contractors recovery of prejudgment interest in construction changes on state public works contracts. You may even want to make that broader and include all public works Alaska contracts, not merely state contracts.

If you have any questions please do not hesitate to contact me.

JPA

----- Headers -----

Return-Path: <mdm.mbcontracting@alaska.com>

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From: "Mike Miller" <mdm.mbcontracting@alaska.com>

To: <thyes@aol.com>

Subject: FW: Prejudgment Interest Alaska Construction Contracts

Date: Mon, 9 Apr 2001 17:23:47 -0800

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Importance: Normal

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