

**BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS ON REFERRAL
FROM THE COMMISSIONER OF EDUCATION AND EARLY DEVELOPMENT**

In the Matter of)
)
Northwest Arctic Borough School District)
_____)

OAH No. 14-0145-EFG

DECISION

I. Introduction

The Northwest Arctic Borough School District (District) submitted a Capital Improvement Project (CIP) application seeking grant funding for a new Kivalina school. The Department of Education and Early Development (DEED) approved the application, but with a much lower cost allocation than the District sought. The District appealed DEED’s decision.

The matter was referred to the Office of Administrative Hearings (OAH) and a hearing was held on February 12 -13, 2014.

This decision finds that DEED had a reasonable basis for its decision. Accordingly, its decision is affirmed.

II. Facts and Proceedings

A. Procedural History

On September 3, 2013, the District submitted its grant application for a replacement K-12 Kivalina school.¹ The grant amount requested was \$100,065,442.² On November 5, 2013, DEED notified the District that it reduced the project cost to \$54,046,749.³ The District requested reconsideration on November 25, 2013.⁴ In its reconsideration decision, DEED increased its recommended project cost to \$61,197,650.⁵

The District appealed DEED’s decision on January 10, 2014.⁶ The District raised six issues in its notice of appeal.⁷ These can be generally categorized as water storage, landfill, gravel, population projections, construction contingency markups, and general requirement

1 R. 1-484 .
2 R. 9.
3 Ex. 9.
4 R. 487- 490.
5 Ex. 2.
6 Ex. 5.
7 Ex. 5.

markups.⁸ These six issues were the focus of the OAH hearing.

At hearing, the District presented testimony from Kathy Christy, project manager, and Jon Hermon, professional civil engineer.⁹ DEED presented testimony from Elwin Blackwell, school finance and facilities section internal auditor.

B. Facts

Kivalina is a remote village on a barrier island bordering the Chukchi Sea.¹⁰ Kivalina's current school, the McQueen School, is at 168% capacity.¹¹ Renovation or additions to the existing school is not a viable option. The school and village itself will eventually be lost to erosion from fierce sea storms.¹² Village residents have explored relocation options for many years; so far without success.¹³ However, residents have agreed on an evacuation road location.¹⁴ The proposed location for the new Kivalina school is at the end of the proposed evacuation road, on Kisimigiuktuk Hill.¹⁵

The proposed school site is approximately eight miles from the current village site.¹⁶ The proposed site is a blank slate. There is no infrastructure, no access, and very little geotechnical information known about the proposed site.¹⁷ School construction cannot begin until the evacuation road is built.¹⁸ Construction will need to include utility and other infrastructure development aside from the actual school building because of the site's remote, undeveloped location. The anticipated occupancy date for the school is 2021.¹⁹

Ordinarily, a District would not apply for funding at such an early, conceptual stage.²⁰ The District applied and DEED accepted the application because of a term in a 2011 settlement agreement.²¹ The application at this early funding date presents unique challenges

8 Ex. 5, District's Notice of Appeal, January 10, 2014.

9 Ex. 6.

10 R. 116.

11 R. 104.

12 R. 116.

13 R. 104.

14 R. 104.

15 R. 104.

16 R. 7. The record contains multiple references to the proposed school site being seven and eight miles from Kivalina village. For purposed of this decision, it will be assumed the location is approximately eight miles from the village. The exact distance from Kivalina is not relevant to this decision.

17 Christy testimony; R. 330.

18 Christy testimony; R. 330.

19 Christy testimony.

20 Blackwell testimony.

21 District's prehearing brief (February 10, 2014); Presentation by counsel for both parties. The District argues

for both the District and DEED. It is undisputed that there are many unknowns regarding construction of the school.

The District’s design for the new Kivalina school is based on a scaled down version of the Noatak school, a recent new construction also located in the District.²²

III. Discussion

A. Legal Standards

1. *Grant Application Process*

School districts may submit CIP grant applications to DEED.²³ DEED reviews the applications, verifies the applications meet statutory requirements, and recommends to the Board of Education and Early Development (Board) a grant schedule.²⁴ DEED is required to prioritize projects²⁵ and provide a budget estimate for each project.²⁶ DEED may modify a project when necessary to achieve cost-effective school construction.²⁷ DEED will, “in its discretion,” reduce a proposed project’s budget if the costs, as determined by the department, are excessive.²⁸ DEED

at hearing that the state is required to fund the new school. This is not an issue at hearing. The state has approved the application through the CIP process and it was not raised as an issue on appeal. In the *Kasayulie*²¹ settlement the parties agreed that the State would include a Kivalina school “renovation/addition” project in the Governor’s proposed capital appropriations budget bill for FY2015.²¹ Specifically, the term stated:

(b) Kivalina K-12 school renovation/addition; appropriation to be effective July 1, 2015. (Amount of appropriation to be determined by the Department of Education and Early Development’s November 2013 Capital Improvement Project process; for reference, the cost of this project from DEED’s November 2010 list was \$14,724,714). However, if the Legislature declines to fund, or places contingencies on the Kivalina school project because of concerns about erosion or viability of school site, the lack of funding or contingencies will have no effect on the settlement, and cannot be used by plaintiffs to reopen this litigation.

The plain language envisions a “renovation/addition” in Kivalina. The District applied for and DEED recommended funding a new construction project, built in response to overcrowding and concerns regarding erosion and viability of the current school site.

The District relied heavily on the *Kasayulie* settlement to support its contention that the State must fund the new construction. The term does not state that DEED must fund a new construction project. However, it is apparent at this stage, that the State has already agreed to fund a new school, but at a lower cost than proposed by the District. Accordingly, with regards to the Kivalina school, the *Kasayulie* settlement, is simply no longer an issue.

- 22 Hermon testimony.
- 23 AS 14.11.011(a).
- 24 AS 14.11.013(a)(1).
- 25 AS 14.11.013(b).
- 26 AS 14.11.013(a)(2).
- 27 AS 14.11.013(c)(1).
- 28 4 AAC 31.022(e).

notifies a district of its CIP application decision in November of each year.²⁹

A district may request reconsideration, and if dissatisfied with DEED's reconsideration decision, may appeal to the OAH.³⁰ A notice of appeal must include, "its specific objections; a summary of the evidence that the department erred in its...scope of the project allowed...or the amount of the project budget approved, and the relief it requests."³¹ Issues not raised in the notice of appeal are considered waived.³²

2. *Standard of Review*

The hearing officer must determine whether the department had a reasonable basis for deciding as it did.³³ DEED's decision has a reasonable basis if it supported by the evidence in the record as a whole, and there is not abuse of discretion.³⁴ A reasonable basis review does not require agreement with the agency's determination.³⁵ The question is not whether the District's request was reasonable, but whether DEED had a reasonable basis for its decision.

The statutory scheme and implementing regulations give DEED considerable discretion when making its grant authorization recommendations to the Board.

B. Issues

1. *Water Storage*

DEED had a reasonable basis for authorizing 500,000 gallons of water storage.

The District is proposing a fill and draw system. The school will not be able to pump water year-round because of frozen conditions. The school will need to draw and store enough water to get through the long arctic winter. Both the District and DEED estimated usage for a full school year when determining appropriate water storage amounts.

The District requested 1,000,000 gallons of water storage. DEED approved half that amount. While DEED disallowed most of the costs of the second 500,000 tank, it did not remove any costs from the District's installation costs estimate, which presumes two tanks.

Mr. Hermon calculated 20 gallons per day, per capita, 3500 gallon per day average rate,

29 4 AAC 31.026(a).

30 AS 14.11.016(a); AS 14.11.016(b).

31 4 AAC 31.026(a).

³² 4 AAC 31.026(c).

33 4 AAC 31.026(h).

34 Regulatory Com'n of Alaska v. Tesoro Alaska co., 178 P.3d 1159, 1163 (Alaska 2008).

35 *Id.*

for 9 months of every year.³⁶ He compared this to 21-24 gallons per day per capita from a Lower Kuskokwim School District (LKSD) water estimates that was shared with him.³⁷ Mr. Hermon also considered a 2003 World Health Organization study, which he stated recommended 13 to 26 gallons per capita per day.³⁸ The District did not provide documentation of the LKSD numbers or the WHO study. Mr. Harmon's estimate also included 500 gallons per day for teacher housing.³⁹ CIP funding is not available for teacher housing.⁴⁰

DEED estimated 10 gallons per day per capita, 1700 gallons per day average rate, 188 days a year.⁴¹ DEED also considered LKSD project estimates and supplied a table from the project's engineers.⁴² A June 2013 estimate of LKSD school water requirements based on 173 users indicates average daily demand of 1,328 and maximum daily demand of 2,656.⁴³ DEED considered the LKSD project in determining estimated daily need.⁴⁴ Mr. Blackwell testified credibly that he is unaware of DEED funding any school project with 1,000,000 gallons of water storage, or with a two tank system.

The number of school days used by DEED is more reasonable than the full 9 months, including weekends, used by the District. DEED, which reviews every project in the state, credibly stated it is the standard number used and that students are required to be "in their seats" 170 days a year. Extra days are included for those lower water usage days when teachers are there without students.⁴⁵

While neither party supplied a hard and fast formula for calculating water storage needs, the preponderance of the evidence supports a finding that DEED's water storage estimate is reasonable.

2. Landfill

DEED had reasonable basis for excluding landfill costs.

36 Ex. C; Hermon testimony (3500 x 270 days = 945,000).

37 Ex. C.

38 Ex. C; Hermon testimony.

39 Harmon testimony.

⁴⁰ Blackwell testimony; 4 AAC 31.900(9).

41 Ex. 2; Blackwell testimony (estimate based on 10 gals per day x 170 users x 188 days = 319,600 gallons needed per year, approved 500,000 gallons per year).

42 Blackwell testimony; R. 513.

43 R. 513. The same LKSD chart does include a column with a 1,000,000 gallon annual demand estimate, but it is calculated based on 254 users, and a combination of actual usage and assumed additional usage. Another column, based on design assumptions, also for 254 users, estimates a 500,000 gallon annual demand.

44 Blackwell testimony.

The District requested funding for a Class II, 6,500-cubic yard capacity landfill.⁴⁶ School staff would deliver waste to an area outside the landfill, an operator would move the waste to the landfill, where it would be burned, compacted, and covered with soil.⁴⁷ Requested landfill operations would require a burn box, dumpsters, and waste handling equipment.⁴⁸

In its reconsideration decision, DEED denied the landfill because it envisioned the waste going into a landfill at the new town site.⁴⁹ At hearing, DEED argued that waste could be transported to the current Kivalina village landfill for disposal.⁵⁰ Mr. Blackwell also testified that he believes it would be more cost effective to transport the waste to the current Kivalina site than to maintain the necessary operations to run a landfill. He noted that under either plan, the District would need a vehicle to transport waste, whether located near the school or eight miles away.⁵¹

Under the proposed plan and because there are no concrete plans to move the town, it is assumed students would be bused to the school site daily from Kivalina. If the District is comfortable busing its most precious resource, its students, 8 miles every day to and from school, it is reasonable for DEED to assume the District can develop a plan for transplanting school waste along the same route.

DEED had a reasonable basis decision to exclude landfill funding.

3. *Gravel*

DEED had a reasonable basis for its gravel determination.

The original application envisioned the need for gravel mining.⁵² It now appears somewhat likely that sources of gravel exist that will not require mining.⁵³ The District agrees that the amount of gravel needed will be less than originally requested, but more than approved by DEED.⁵⁴

DEED's decision characterized "allowed areas" and "ineligible areas" for gravel.

⁴⁵ Blackwell testimony.

⁴⁶ R. 501.

⁴⁷ R. 501.

⁴⁸ R. 501.

⁴⁹ Ex. 2.

⁵⁰ Blackwell testimony.

⁵¹ Blackwell testimony.

⁵² R. 336.

⁵³ R. 488.

⁵⁴ R. 488.

DEED approved 23,144 cubic yards of gravel for allowed areas.⁵⁵ In its reconsideration decision, DEED authorized the amount of cubic yards requested in the District’s application for “allowed areas.”⁵⁶ DEED did not authorize gravel for ineligible areas, which it described as roads to the sewage lagoon, landfill, and water infiltration facility.⁵⁷

In its reconsideration request, the District asks for an additional 11,395 cubic yards in allowed areas and 6240 cubic yards in what DEED characterized as ineligible areas.⁵⁸ The District states that CRW Engineering calculated a total of 34,539 cubic yards needed for the allowed areas.⁵⁹ The District did not provide support for that number at hearing, nor is it clear from the agency record what allowed areas the requested 34,539 cubic yards covers. The District does not dispute the \$80 per per cubic yard cost authorized by DEED.⁶⁰

The requested gravel for the access roads to the sewage lagoon, water infiltration facility, and landfill were all denied as ineligible.⁶¹ However, the District makes a strong argument for access road gravel approval. The theory is that DEED builds schools, not utilities. In this case, though, DEED authorized the sewage lagoon and water infiltration facility. The District argues, reasonably, that if DEED is authorizing the construction and gravel needed for these areas, it should authorize gravel for access to these areas.

DEED successfully rebutted this argument through testimony. DEED testified credibly that the sewer lagoon and water infiltration site will need to be accessed very infrequently.⁶² DEED argued that access, when needed, would be available along the pipeline access routes that will run from both the sewer lagoon and the water infiltration facility.⁶³

It was reasonable for DEED to deny funding for access road gravel to the landfill when it did not approve landfill construction. DEED denied access road gravel funding for the sewer lagoon and water filtration even though it approved construction of those sites. It is reasonable for

55 Ex. 9.

56 Ex. 2, R. 474; R. 411; R. 417 (11,000 cu yd for roads and walkways at school + 10,000 cu yd for the playground + 1,044 cu yd for the water tank + 1,100 cu yd for the lagoon).

57 Ex. 2.

58 Ex. 2; R. 488.

59 Ex. 2; R. 488.

60 R. 488.

61 Ex. 2.

62 Blackwell testimony.

63 Blackwell testimony. R.110 shows proposed roads and pipelines. The evacuation road is unknown. It may be possible to provide water or sewer lagoon access off the proposed road. Mr. Hermon also testified that the best

DEED to exclude access roads to these locations when another access route is available. There is also possibility for sewer and water access from the evacuation road. Furthermore, the agreed upon \$80 per cubic yard gravel cost, combined with the likeliness that a gravel source may be located without the need for mining, make DEED's overall gravel determination reasonable. The evidence supports DEED's gravel authorization as reasonable.

4. *Population Projections*

Amending the CIP process to allow future population projections is beyond the scope of hearing.

Allowable square footage is based on projected student populations. The District's points on appeal did not challenge DEED's recommended square footage allotment. Instead, the District requests the opportunity to update projected student population numbers closer to actual construction.⁶⁴

The CIP program does not currently have a process in place to allow population recalculation at a later date.⁶⁵ DEED allows population projects only seven years out, which ordinarily covers five years of school occupancy.⁶⁶ The Kivalina school has a much longer build timeframe. The District, if additional funding was needed due to population increases, would have to obtain funding through the legislature or through a new application.⁶⁷

The hearing scope is limited to whether DEED had a reasonable basis for its decision.⁶⁸ The square footage, as of DEED's reconsideration decision, is reasonable. It is also reasonable for DEED to abide by its current process in determining grant awards.

The parties are encouraged to develop a process for revisiting projected student population closer to actual construction. However, creating that avenue is outside the scope of this hearing.

5. *Markups*

This decision considered the contingency markups, general requirement markups, overall markups, and calculation method. Actual approved construction costs were just over \$30

scenario would be wells to access water, thereby creating less storage and road needs. Unfortunately, like many other aspects of this project, the viability of well drilling is too speculative to rely upon.

⁶⁴ Ex. 5. The District's application and reconsideration requested funding for a 35,835 sq. ft. school, based on its projected student population. DEED originally authorized 31,007 square feet. Upon reconsideration, DEED increased the approved square footage to 34,425, a number which the District is not challenging.

⁶⁵ Blackwell testimony.

⁶⁶ Blackwell testimony.

⁶⁷ Blackwell testimony.

⁶⁸ 4 AAC 31.026(h).

million.⁶⁹ The remainder of the \$61 million approved grant is for indirect costs and markups.⁷⁰ What that means is for every \$1 million disallowed in direct construction costs, the District saw another \$1 million reduction in indirect and markup costs.

Construction markups are applied to construction costs after general requirement markups.⁷¹ General requirement markups are calculated in a compounding fashion.⁷² For example, the 13.25% general requirement markup is multiplied by the \$30,406,435 construction cost for a total of \$34,435,288.⁷³ The risk & profit markup is then calculated from this number, the construction cost and the general requirement markup for a total of \$37,362,288.⁷⁴ This continues for the remainder of the construction markups.⁷⁵

i. *Construction Contingency Markups*

DEED had a reasonable basis for its approval of a 10% contingency markup.

The District originally challenged the contingency, escalation and general requirement markups.⁷⁶ Upon reconsideration, DEED approved the requested 22.19% escalation markup.⁷⁷ DEED did not increase the contingency or general requirement markups.⁷⁸

The District requests a 15% contingency markup based on a recommendation from its estimator, HMS.⁷⁹ HMS recommends a 15% markup due to the conceptual nature of the drawings, infrastructure development, and building systems used.⁸⁰

DEED allowed a 10% contingency markup based on its program cost model, also developed by HMS.⁸¹ The program cost model states, “The general design contingency is designed to accommodate unknowns due to the conceptual level of the design.”⁸² Mr. Blackwell testified credibly that the 10% contingency markup is for conceptual stage projects and it has

69 R. 577.

70 R. 577.

71 Blackwell testimony.

72 Blackwell testimony; R. 577.

73 R. 577.

74 R. 577.

75 R. 577.

76 R. 489.

77 Ex. 2; R. 577.

78 Ex. 2.

79 Ex. 5.

80 Ex. 5.

81 R. 532; R. 577. The program cost model authorized a 15% contingency mark up for renovation, not new construction. The cost model is updated every two years and last updated in April 2013.

82 R. 532.

historically been quite reliable.⁸³

Both parties rely on HMS numbers. The District believes 15% should be approved because HMS states that it is appropriate for the higher amount of unknowns associated with this specific project.⁸⁴ DEED argues that HMS, as the District’s project estimator, has an incentive to overestimate, ensuring adequate funds for the project. DEED argues that its program cost model, created by HMS to cover the entire spectrum of projects in the state, and developed while not wearing its “contractor” hat, is more appropriate.

“Many unknowns,” is the common theme for this project. The District argues that costs will be much higher due to the remote, away from town location, and that the project is entirely unique in that regard. However, project construction will not start until the evacuation road is built to the school site. At that point, access will be less of an issue. Once the road is complete and aside from the need for utilities, this project will be much like any other remote artic construction project, full of challenges under the best of circumstances.

DEED’s reliance on its program cost model for the 10% contingency markup is reasonable. It has been successful for an array of past projects at the conceptual phase. While this project may be “more conceptual” than most, the District has not shown by a preponderance of the evidence that DEED’s denial of its requested 15% markup lacks a reasonable basis.

ii. *General Requirement Markups*

DEED had a reasonable basis for its General Requirements markups.

General requirements are indirect contractor costs.⁸⁵ Neither the District nor DEED went into any analysis of specific general requirement costs at hearing. The District’s position is that, “The General Requirement markup suggested by the Department is too low to reflect costs and condition for Kivalina.”⁸⁶ The District did not specifically state the general requirement markup it was seeking.⁸⁷

Like the contingency markup, DEED approved a 13.25% general requirement markup based on its program cost model.⁸⁸ At 13.25% of the approved \$30,406,435 construction cost the general requirements markup equates to \$4,0288,853.

83 Blackwell testimony.
84 Christy testimony; R. 491.
85 R. 491; Blackwell testimony.
86 R. 489.
87 Ex. 5; R. 489.

At hearing, the District did not address cost specifics of the general requirements markup. The District indicated higher general requirements markups are needed due to the remote location and need for construction camps. Mr. Blackwell testified that geographic area cost factor was already included in the estimate.⁸⁹ He also testified credibly that general requirements markups for rural sites regularly include construction of worker camps.⁹⁰ Mr. Blackwell stated that because every space in rural communities is occupied, camps must be set up with worker services wherever the school site is located.⁹¹

HMS did not use the percentage method employed by the state and states that, “general requirements cannot be based on percentage and should be developed for actual activities to take place during construction.”⁹² This appears incongruous with the 13.25% “Mobilization, General Operating Costs and Office Overhead” markup in the cost model, developed by HMS.⁹³

DEED’s 13.25% general requirements markups award is reasonable based on the record.

1. *Project cost overview*

The District argues that DEED’s approved project cost is not enough to ensure construction. At the same time, both the District and DEED recognize that many variables remain unknown and will continue to remain unknown until years down the road. Regardless of the project’s uncertainties, both parties are committed to ensuring a new school for Kivalina.⁹⁴

This project will necessarily cost more than a standard school construction project because of its undeveloped location and lack of local utilities. DEED approved just over \$61 million dollars for a school to serve 144 children. The District’s application requested construction costs of \$2,521 per square foot.⁹⁵ DEED approved construction costs of \$1,494.51 per square foot,⁹⁶ a

88 Blackwell testimony.

89 Blackwell testimony; R. 558.

90 Blackwell testimony.

91 Blackwell testimony.

92 R. 395- 403 (It appears from the record that “general requirements” may be the same as “general conditions and profit” listed in the construction cost estimate. The “general conditions and profit” totals \$7,809,466, \$3,744,729 in costs and \$4,064,737 in “mark-ups.” Because the record does not contain an explanation of the interplay between the \$4,064,737 “mark-ups” included in the general conditions and profits section [R.396] and the profit markup on DEED’s reconsideration decision [R. 577], this decision does not make findings on specific costs or cost/profit interplay).

93 R.572.

94 Presentation of parties at hearing.

95 R. 11, R. 13 (construction total, \$90,361,834/35,835, square footage)

96 R. 577.

cost that is \$542 per square foot greater than the next highest new construction cost.⁹⁷ The approved cost is also \$799 greater, or more than doubles the cost, per square foot than the Noatak replacement, on which the proposed Kivalina school is based.⁹⁸

While the District appealed the recommended grant amount as inadequate, it did not provide persuasive evidence that the approved project costs would fail to provide for construction of an adequate school. Mr. Hermon and Ms. Christy both testified that in their opinions the nearly 40% reduction might be too deep of a cut. HMS, the District’s professional estimator, states, “Overall, the building construction cost may be conservative due to early design parameters and may come down based on actual design documents, but not as low as DEED is suggesting.”⁹⁹ The District’s points on appeal “recognizes that its estimated cost of the Kivalina project may decrease but to a far lesser degree than the reduction proposed by the Department.”¹⁰⁰

While the District provided some evidence indicating that the approved project cost was generally considered too low, it failed to show that DEED lacked a reasonable basis for its decision.

IV. Conclusion

The record shows that DEED had a reasonable basis for its \$61,197,650 CIP award. The District did not show DEED’s decision lacked a reasonable basis. DEED’s decision is therefore affirmed.

DATED this 7th day of March, 2014.

Signed

Bride A. Seifert

Administrative Law Judge

97 R. 521.

98 R. 521.

99 R. 491.

100 Ex. 5.

Adoption

The Alaska Board of Education and Early Development adopts this decision as final under the authority of AS 44.64.060(e)(1). Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with AS 44.62.560 and Alaska R. App. P. 602(a)(2) within 30 days after the date of this decision.

DATED this 14th day of March, 2014.

By: Signed
Signature
Jim Merriner
Name
Board Chair
Title

[This document has been modified to conform to the technical standards for publication.]