**BEFORE THE STATE OF ALASKA OFFICE OF ADMINISTRATIVE HEARINGS ON REFERRAL FROM THE COMMISSIONER OF THE DEPARTMENT OF ADMINISTRATION**

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| In the Matter of the Alaska | ) | |
| Supply Chain Integrators Contract | ) | OAH No. 05-0581-CON |
| | ) | Contract No. 2004-9900-4556 |

## DECISION AND ORDER

### I. Introduction

This is a contract claim by the Division of General Services against Alaska Supply Chain Integrators (ASCI). It raises a single issue about who bears the cost of a keypunch error made by an ASCI employee purchasing supplies for a state agency. ASCI was performing under the Procurement and Warehouse Services contract entered into with the division. The error gave rise to a $189 liability to the supplier. The state paid the supplier, the division requested reimbursement from ASCI, ASCI refused and the division filed this contract claim. The parties agreed that the division's contract claim raises a legal issue of contract interpretation that does not require an evidentiary hearing.

Review of the written record, briefs submitted by the parties, and the relevant law reveals that the contract between ASCI and the division did not pass the risk of loss for errors of this type from ASCI to the state. The contract requires ASCI to indemnify the state for third-party claims arising from errors by ASCI's employees. It makes no exception for what ASCI calls "operational errors." The supplier's demand for payment is a "claim" within the meaning of the indemnity provision. ASCI, therefore, must indemnify the state in the amount of $189.

### II. Facts

The legislature authorized a pilot project on the outsourcing of state purchasing.[1] The division issued a request for proposals (RFP) for a contractor to perform the pilot project.[2] The RFP solicited offers to participate in the project from contractors with procurement, supply chain management and electronic commerce tools experience.[3] Among other things, the RFP's Scope of Work section (Section 5) called for the contractor to acquire supplies and manage warehouse

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1 *See generally* 2003 SLA, ch. 51.
2 November 4, 2003 RFP.
3 *Id.* at pp. 7 & 25.

functions, and to "act as an agent of the state when procuring services and supplies, or administering third-party contracts."[4]

In the initial RFP, Section 5 set out four groups of expectations about the Status of Contractor as the state's agent. One called for all third-party claims to be "resolved directly between the contractor and third-party contractors."[5] The other three addressed expectations regarding administration of existing state contracts with third parties, inter-governmental and facility use agreements, and vessel construction and maintenance contracts, including the expectation that the contractor selected would assist the state in defending against third-party claims.[6] Section 5, as initially crafted, did not define "claims" or speak to the contractor's responsibility for errors and omissions.[7]

The initial RFP was amended several times. Some amendments were in direct response to concerns ASCI raised about the Status of Contractor language in RPF Section 5. Specifically, through correspondence during the pre-proposal period, ASCI raised concerns about potential liability the selected contractor might face for matters beyond its control and claims or other liabilities resulting from no fault of the contractor.[8] As a result, RFP Section 5 was amended to

- delete the vessel construction and maintenance contract duties,
- allocate responsibility for errors as between the contractor and the state,
- apportion fault for joint-responsibility claims, and
- define "claims" as that word is used in RFP Section 5 (Scope of Work).[9]

ASCI submitted a detailed written response to that amendment, asserting that even as amended the RFP still left the contractor with "inordinate legal risk" and recommending further changes to the Status of Contractor language.[10] ASCI recommended that one of two things be done: (1) include in the contract a hold harmless clause that would protect the contractor from "intentional, malicious and illegal behavior" or (2) authorize the contractor to "bind the state contractually on the state's own contract documents …."[11] RFP Section 5 was amended again

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4 *Id.* at p. 27.
5 *Id.* at p. 27, Status of Contractor ¶ 1.
6 *Id.* at p. 27, Status of Contractor ¶¶ 2-4.
7 *See generally id.* at pp. 27-39.
8 *E.g.*, ASCI's December 9, 2003 letter at pp. 5-6 (discussing Status of Contractor concerns when addressing issues raised at the pre-proposal conference); *also* December 15, 2003 email from Hawkins (ASCI) and Harvey (division).
9 December 29, 2003 RFP No. 2004-9900-4556, Amendment 2 at p. 6.
10 ASCI's January 2, 2004 letter at pp. 4-7.
11 *Id.* at pp. 5-6.

(Amendment 3) to incorporate ASCI's second recommendation—authorizing contractor use of the state's forms.[12] Amendment 3 also deleted the requirement that "[a]ll claims … be resolved directly between the contractor and third-party contractor…" about which ASCI has expressed concern.[13]

With slight revisions, Amendment 3 retained the changes made by the previous amendment regarding responsibility for errors, apportionment of joint-responsibility claims, and defining "claims." Specifically, it provides the following:

- "The contractor is individually responsible for its errors or omissions in providing all services listed above" (referring to the three-item list encompassing procurement and contract administration services);[14]
- "The contractor shall not be required to respond to claims of, or liability for, any errors or omissions in the initial order instructions by the state requestor or other actions of the state's end user customer that result in a claim."[15]
- "A claim of joint responsibility by the contractor and the state shall be apportioned on a comparative fault basis …."[16]

Amendment 3 went on to define "claims," as used in RFP Section 5 (Scope of Work), including the last two bullet points above, to mean "all contract disputes involving, among other, suppliers, vendors, product manufacturers and delivery service providers."[17]

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[12] January 7, 2004 RFP No. 2004-9900-4556, Amendment 3 at p. 2.

[13] *Id.*

[14] Amendment 3 makes changes to page 27 of the initial RFP. The amendment uses the language "services listed above." The only services actually presented in list form anywhere above the sentence on or before page 27 of the RFP are the procurement and contract administration-related services the contractor was to perform as an agent. The remainder of the RFP appearing "above" the page 27 addition does not list services; at most, it describes them generally. *See* November 4, 2003 RFP at pp. 1-27. The contractor responsibility language in Amendment 3, therefore, applies to the procurement and contract administrator services to be performed by the contractor as an agent.

[15] January 7, 2004 RFP No. 2004-9900-4556, Amendment 3 at p. 2.

[16] *Id.*

[17] *Id.* In the second amendment, the definition of "claims" used the phrase "including but not limited to" instead of "among others." See December 29, 2003 RFP No. 2004-9900-4556, Amendment 2 at p. 6. Each phrase has the effect of providing that a contract dispute with someone other than one of the listed entities may be a "claim."

The RFP was amended three more times, mostly to extend the deadline for responses.[18] ASCI timely filed a response to the RFP.[19] The response included ASCI's acknowledgment that it had received Amendment 3 before submitting its response.[20]

On March 19, 2004, the division and ASCI executed the Procurement and Warehouse Services contract. The contract document consisted of a standard form contract with four appendices, one of which covered indemnity and insurance requirements.[21] Among other things, that appendix requires ASCI to indemnify the state for claims "arising directly or indirectly out of any act, error or omission by [ASCI], its agents, and its employees …."[22] Another of the appendices incorporates the RFP's Scope of Work as the contract's "scope of work/services."[23] The contract was amended several times in 2004 and 2005, but none of those amendments changed the indemnity provision or the RFP Scope of Work's requirements regarding Status of Contractor as described in RFP Amendment 3.[24]

After ASCI began performing under the contract, one of ASCI's employees made a keypunch error that resulted in a supplier charging a $189 restocking fee when erroneously ordered goods were returned.[25] The state paid the supplier $189 without disputing either the amount of the fee or the propriety of the supplier charging it, and without tendering the matter to ASCI so that ASCI could dispute the supplier's charge if it had a basis on which to do so.[26] The

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[18] January 9, 2004 RFP No. 2004-9900-4556, Amendment 4; January 13, 2004 RFP No. 2004-9900-4556, Amendment 5; January 16, 2004 RFP No. 2004-9900-4556, Amendment 6.

[19] ASCI's January 28, 2004 Response to State of Alaska Request for Proposal Number 2004-9900-4556.

[20] *Id.* at sixteenth page from cover (showing Hawkins of ASCI acknowledging receipt of Amendment 3 on January 23, 2004).

[21] March 19, 2004 Procurement and Warehouse Services contract at Appendix B.

[22] *Id*. at Article 1.

[23] March 19, 2004 Procurement and Warehouse Services contract at Appendix C.

[24] *See* Amendment to Standard Contract Form numbered one through six, executed between July 23, 2004, and July 1, 2005 (covering subjects such as equipment use, payment schedules and the like).

[25] ASCI's May 26, 2005 letter at pp. 1-2 (explaining that the state's reimbursement request concerned "a re-stocking charge that is routinely charged by vendors when an order is returned for any reasons …"). Elsewhere, the record suggests that the keypunch error resulted in the state paying $189 for a custom item that could not be returned. *See* Division's February 17, 2005 letter quoting an audit report characterizing the error as "a typo … by an ASCI buyer that resulted in an additional cost to the state in the amount of $189.00 [because t]he item was custom made and could not be returned for credit"); *also* Division's May 9, 2005 letter. More likely than not, the restocking fee characterization is accurate because ASCI was in a better position to know how the charge arose than a third-party auditor. In any event, the nature of the liability arising from the error—i.e., an obligation to pay money to a supplier as a result of an order for goods—is the same whether the supplier was paid a restocking fee for an item that might be resold or for a custom item that could not be returned. For the sake of simplicity, this decision will use the restocking fee characterization.

[26] Division's September 12, 2005 brief at p. 7 (acknowledging payment and lack of tender ); ASCI's May 26, 2005 letter at p. 2 (asserting that "[t]here was no dispute of the appropriateness of restocking fees [and that] the State paid the fees without dispute").

division requested reimbursement from ASCI.[27] ASCI refused. The division filed this contract claim seeking recovery of $189 from ASCI under the Procurement and Warehouse Services contract.

**III. Discussion**

The division's claim for reimbursement raises an issue of contract interpretation that ASCI and the division both agreed could have broader implications than reimbursement of $189. They disagree about whether the costs of what ASCI calls "operational errors" (e.g., a simple keypunch mistake) are part of the state's cost of doing business under the contract or are costs that ASCI, as the contractor, must absorb. The question is readily answered by the indemnity provision of the contract. First, however, it is necessary to address whether authority exists for the division's claim to be adjudicated under AS 36.30.

**A. AUTHORITY TO ADJUDICATE THIS CONTRACT CLAIM**

This claim raises a threshold jurisdictional issue because it arises from a procurement transaction under the pilot project. Contract claims arising out of procurements under AS 36.30 are within the mandatory jurisdiction of the Office of Administrative Hearings (OAH), which hears such claims on behalf of the Commissioner of Administration.[28] The law authorizing the pilot project states that "[a] procurement conducted by [the selected contractor] is not subject to AS 36.30."[29] This exemption of the underlying procurement transaction from AS 36.30 raises a question about whether the division's contract claim seeking reimbursement for a liability arising from such a transaction is itself subject to adjudication under AS 36.30.

The parties were asked to file supplemental briefing on this jurisdictional question.[30] Both the division and ASCI took the position that exemption of the pilot project procurements from AS 36.30 does not exclude from adjudication under AS 36.30 contract claims between ASCI and the division resulting from an error in an exempt procurement.[31] Because the parties agree that this claim should be adjudicated under AS 36.30, and because OAH has authority to hear matters not within its mandatory jurisdiction,[32] the claim will be decided as if subject to AS

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[27] Division's February 17, 2005 letter.

[28] AS 44.64.030(a)(22); AS 36.30.620(f) (providing for contract claims by the state to be referred to the Commissioner of Administration if they cannot be resolved between the procurement officer and contractor).

[29] 2003 SLA, ch. 51, § 2(c).

[30] November 2, 2005 Interim Order on Supplemental Briefing and Submission to the Record.

[31] *See* Division's November 15, 2005 letter (explaining that the RFP called for the contracted to be administered under AS 36.30); ASCI's November 16, 2005 letter (agreeing with the Division's position).

[32] AS 44.64.030(b).

36.30, without reaching the legal question of whether the exemption removed claims between the state and ASCI from the formal adjudication requirements of AS 36.30.

## B. RESPONSIBILITY FOR ERRORS UNDER THE CONTRACT

The issue in this contract claim is whether ASCI must bear the cost of its employee's keypunch error that caused a supplier to charge a $189 restocking fee. The parties disagree about whether ASCI must bear the cost: the division takes the position that RFP Amendment 3 leaves ASCI responsible; ASCI takes the position that it does not—rather that the amendment precludes the division's claim because it is not a third-party claim. They also disagree about whether extrinsic evidence should be used to interpret the contract.

Whether ASCI must bear the cost of its employee's error depends on interpretation of the contract. "Ordinarily, the meaning of a contract presents a question of law …."[33]

> The goal in interpreting the meaning of contracts is to give effect to the reasonable expectations of the parties. Reasonable expectations may be ascertained through the language of the contract, the behavior of the parties, case law, and any relevant extrinsic evidence.[34]

The starting point is the plain language of the contract itself.[35] Extrinsic evidence becomes relevant only when the contract language is ambiguous, or to show that the language is ambiguous.[36] It cannot be used to vary the plain, unambiguous terms of a contract.[37]

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33 *Harris v. AHTNA, Inc.*, 107 P.3d. 271, 274 (Alaska 2005).

34 *Id*. (footnotes omitted).

35 *See, e.g., Harris*, 107 P.3d at 274-277 (analyzing language of buy-or-sell agreement paragraphs before resorting to other sources or authorities); *also United Airlines, Inc., v. State Farm Fire & Casualty Co.*, 51 P.3d 928, 934 (Alaska 2002) (determining liability based on "interpretation of the plain language of the indemnity clause" in a sublease).

36 *National Bank of Alaska v. J.B.L. & K. of Alaska, Inc.*, 546 P.2d 579, 583-587 (Alaska 1976) (discussing evolution of case law on use of extrinsic evidence and demonstrating that evidence of the circumstances surrounding formation of the contract can be used both to resolve ambiguities and to establish that they exist).

37 *Id.* at 583 (explaining that for integrated agreements the parol evidence rule "bars the introduction of extrinsic evidence to add or to vary the terms of the written agreement"). An agreement is integrated if it "'reasonably appears to be a complete agreement'" based on the completeness and specificity of the writing. *Lower Kuskokwim School District v. Diversified Contractors, Inc.*, 734 P.2d 62, 64 (Alaska 1987) (quoting the Restatement (Second) of Contracts). The Procurement and Warehouse Services contract, which consists of specific, detailed terms in the standard contract, its appendices and the incorporated RFP and amendments, is an integrated agreement.

In their briefing, both parties focused on RPF Amendment 3, collectively raising only two potential interpretation questions: one about what Amendment 3 did to ASCI's indemnity obligation and another about the meaning of the word "claims."[38]

*1. Scope of Indemnity Obligation with RFP Amendment 3*

The division and ASCI disagree about whether RFP Amendment 3 narrows the broad indemnity obligation created by Article 1, Appendix B of the contract to exclude liability for costs arising from seemingly small mistakes such as the keypunch error that led to the $189 restocking fee. ASCI argues that RFP Amendment 3, in effect, created two classes of disputes: (1) disputes giving rise to third-party claims, for which ASCI admits it is responsible if caused by an ASCI-employee error,[39] and (2) direct disputes between ASCI and the state over the contractual relationship. ASCI asserts that disputes over mistakes of the type a state employee might have made performing the procurement function fall into the second category, are a cost of doing business for the state, and do not trigger the indemnity obligation. The division disagrees, arguing essentially that RFP Amendment 3 reinforces ASCI responsibility for ASCI-employee errors and does not preclude the division's direct contract claim for reimbursement.

What, if any, effect RFP Amendment 3 has on ASCI's indemnity obligation depends on the meaning of the Article 1, Appendix B indemnity provision. It states:

> The Contractor shall indemnify, save harmless, and defend the State of Alaska, its agents and its employees from the [sic] any and all claims, actions, or liabilities for injuries or damages sustained by any person or property arising directly or indirectly out of any act, error, or omission by the Contractor, its agents, and its employees connected with the Contractor's performance under this Contract; however, this provision has no effect if, but only if, the sole proximate cause of the injury or damage is the State of Alaska's negligence.

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[38] ASCI's also argued that the insurance provisions of the contract do not require coverage for errors of the type in question here. ASCI's September 14, 2005 letter-brief at p.4. Insurance requirements, like many other provisions of a contract, are subject to negotiation. Contracting parties conceivably could agree that all risks of every type must be covered by insurance and might even do so, if such insurance coverage could be obtained at a commercially reasonable rate. ASCI cited no law to support its implied position that an uninsured risk falls to the contracting party that did not require the other party to insure against it. Based on the record, more likely than not, the scope of ASCI's required insurance coverage was the product of the parties' mutual understanding of commercially reasonable insurance requirements, not an expression of their intent about who would bear the risk of loss from ASCI-employee errors.

[39] ASCI's September 14, 2005 brief at pp. 2, 4 & 6-7 (emphasizing ASCI's position that it accepted liability for third party claims but not for direct claims by the state for routine "operational error"); *also* September 13, 2005 Affidavit of David Barry Jackson at p. 3 (stating the following: "In every one of our discussions and consultations on this topic [status of the contractor] it was clear to me that ASCI understood the amendments put forth by the State to mean that ASCI would be responsible for its errors and omissions in dealing with third parties (not the State)").

In simplest terms it requires ASCI to indemnify (as well as defend) the state for claims resulting from ASCI-employee errors but not for injury or damage caused solely by the state's negligence. It does not explain what "claims" means in this context.

ASCI correctly points out that the indemnity provision should be read as applying only to claims by third parties. Indemnity flows from the indemnifying party (ASCI) to the indemnified party (the state) when the latter incurs liability to a third party. The division's counter that in RFP Amendment 3 the term "claims" is defined broadly enough to encompass any contract dispute arising out of an ASCI procurement misses the point that the division's contract "claim" on behalf of the state under AS 36.30 for reimbursement of the supplier's restocking fee is not itself a claim for which ASCI must indemnify (or defend) the state under Article 1, Appendix B of the contract. Rather, it is a direct contract claim for reimbursement of money the state paid in satisfaction of a demand by the supplier—a third party. Thus, the question becomes whether the supplier's undisputed demand for payment of $189 is a third-party claim within the meaning of the indemnity provision.

ASCI's position that the $189 fee is simply a cost to the state (not ASCI) of doing business rests on the notion that RFP Amendment 3, read in light of relevant extrinsic evidence, exempts a class of errors ASCI refers variously to as "operational" or "routine" or "ordinary" from giving rise to third-party claims. The language of RFP Amendment 3 and the parties' correspondence leading to it do not support a conclusion that the parties contracted for such an exemption. To the contrary, they support the conclusion that RFP Amendment 3 narrowed the Scope of Work the contractor would have to perform as an agent of the state, and reduced the contractor's risk of exposure to third-party claims arising through no fault of its own, but did not alter the indemnity obligation for third-party claims arising from its own errors or those of its employees.

RFP Amendment 3 grew out of extensive pre-proposal communications between ASCI and the division about the Status of Contractor portion of the RFP Scope of Work section (Section 5). The practical effect of this pre-proposal exchange was negotiation of requirements destined to become part of the contract. ASCI secured relief from responsibility for vessel construction and maintenance contracts, and from having to resolve all third-party claims itself, directly with the third party.[40] Through the amendment, ASCI obtained authority to use state

[40] January 7, 2004 RFP No. 2004-9900-4556, Amendment 3 at p. 2.

forms, to minimize the risk of being targeted by claims meant for the state.[41] The amendment also apportioned liability for joint-responsibility claims and made clear that the contractor would not have to respond to claims if "the initial order instructions by the state requestor or other actions of the state's end user customer that result in a claim."[42] Finally, the amendment retained assisting the state in asserting or defending against certain claims as part of the contractor's Scope of Work.[43]

In short, RFP Amendment 3 made significant changes to the Scope of Work affecting the contractor's risk of incurring costs related to third-party claims. The reasonable expectations of both contracting parties—ASCI and the division—regarding responsibility for third-party claims were different when they executed the contract incorporating RFP Amendment 3 than they would have been had the RFP not been amended. Amendment 3, however, did not create a reasonable expectation that third-party claims resulting from ASCI-employee errors would be paid for by the state, as a cost of doing business, with no right of reimbursement from ASCI under the indemnity provision.

ASCI's belief to the contrary appears predicated on two bits of limiting language in RFP Amendment 3: one in the sentence discussing the contractor's responsibility for errors; the other in the definition of "claims."

a. Contractor responsibility for errors under Amendment 3

RFP Amendment 3 states that the contractor is "individually responsible for its errors or omissions in providing all services listed above[,]" referring to a three-item list encompassing procurement and contract administration services.[44] ASCI points out that the "services listed above" language limits applicability of this individual responsibility provision to services encompassed in three numbered points on page 2 of Amendment 3, and that these are services to be performed by the contractor as an agent of the state. The three numbered points describe procurement and contract administrator services to be performed by the contractor as the state's agent. The parties do not dispute that the ASCI-employee error that led to the $189 restocking fee occurred when ASCI was performing procurement services as an agent of the state. Thus, the

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41 *Id.*; December 15, 2003 Emails between Hawkins (ASCI) and Harvey (the division) (discussing ASCI's experience with being sued when it had done nothing wrong); January 6, 2004 Emails between Harvey (division) and Thompson (state's risk manager) (preparing language to allow use of state contract forms in response to ASCI's concerns).

42 January 7, 2004 RFP No. 2004-9900-4556, Amendment 3 at p. 2.

43 *Id.*

44 *Id.*

limiting language does not preclude the division from invoking the Amendment 3 individual responsibility provision in its direct contract claim.

Even if it did, however, limiting the applicability of this specific expression of individual responsibility for errors would not narrow the indemnity provision in Article 1, Appendix B of the contract. The indemnity provision contains its own expression of individual responsibility when it states unequivocally that the contractor "shall indemnify" the state for "any and all claims … arising directly or indirectly out of any act, error, or omission by the Contractor, its agents, and its employees connected with the Contractor's performance under this Contract."[45] Nothing in RFP Amendment 3 changes that indemnity obligation as long as the ASCI-employee error in question led to a "claim" for which ASCI is solely responsible.

b. <u>"Claims" as defined in Amendment 3</u>

RFP Amendment 3 defines "claims" as "all contract disputes involving, among others, suppliers, vendors, product manufacturers and delivery service providers."[46] ASCI's argument questions whether the supplier's restocking fee constitutes a claim for which ASCI owes the state indemnity because this unambiguous definition of "claims" has limited applicability. ASCI is correct: by its own terms, the definition in Amendment 3 applies to the "section" in which it is used—i.e., the section of the RFP addressing the contractor's status as an agent of the state in the context of the Scope of Work (RPF Section 5). Nothing in that section explicitly links the amendment's definition of "claims" back to the indemnity provision in Article 1, Appendix B of the contract.

The Amendment 3 definition of "claims" does not govern how the word "claims," as used in the indemnity provision phrase "all claims, actions, or liabilities[,]" should be interpreted. Nothing in RFP Amendment 3, or in the documented negotiations that led to it, purports to define "claims" as used in the indemnity provision or to limit ASCI's indemnity obligation to just the subset of claims specifically discussed in the amendment. Accordingly, the question becomes what does "claims" mean in the context of the indemnity provision.

*2. "Claims" for Indemnity Purposes*

For indemnity purposes, "claims" could be given its ordinary plain language meaning or a specific technical meaning, if the reasonable expectations of the parties so dictated. Thus, an ambiguity exists in the indemnity provision. Extrinsic evidence can be used to resolve the

[45] March 19, 2004 Procurement and Warehouse Services contract at Appendix B, Article 1.
[46] January 7, 2004 RFP No. 2004-9900-4556, Amendment 3 at p. 2.

ambiguity, but not to vary the contract's terms.[47] The parties' correspondence leading up to execution of the contract on March 19, 2004, provides the most useful extrinsic evidence from which to deduce their intent, if any, to specially define "claims" for indemnity purposes.[48] That correspondence does not show that the parties intended a particular technical meaning for the word "claims" in the context of a third-party claims for which ASCI would have to indemnify the state.

The correspondence evidences ASCI's concern about the amount of legal risk it would be assuming under a contract including the RFP terms unless those terms were changed.[49] The focus of ASCI's concern, and of the division's response to it, was on the risk of ASCI becoming a target of lawsuits or having to respond to claims when ASCI had done nothing wrong.[50] The closest the evidence of the parties' negotiations comes to raising a concern about ASCI being held responsible for its employees' errors lies in the following assertion by ASCI:

> A contractor will use just as much care and caution as a state employee in establishing and administering contracts. Both should be protected in a similar manner.[51]

This assertion, taken in context with the balance of the seven-page justification for ASCI's proposed changes in which it appeared, stops far short of showing that ASCI had a reasonable expectation its liability for claims due to ASCI-employee errors would be limited based on the nature of the errors.

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47 *National Bank of Alaska*, 546 P.2d at 583.

48 "Extrinsic evidence" is simply evidence from outside the contract document itself. The Procurement and Warehouse Services contract document consists of the standard contract form and its appendices, and incorporates the RFP, as amended. Documents evidencing the parties' negotiations leading up to or created contemporaneously with execution of the contact more likely than not provide better evidence of the parties' intent and reasonable expectations than letters or affidavits written months later, after a contract dispute has developed.

49 ASCI's December 9, 2003 letter at p. 6 (detailing many concerns about the RFP, including that the RFP's Status of Contractor language was an attempt by the state to outsource its "contracting risk and associated legal liability" but without suggesting that "claims" needed to be given a technical meaning to address this concern); ASCI's January 2, 2004 letter at pp. 4-5 (characterizing RFP Amendment 2 as requiring the contractor to "accept inordinate legal risk").

50 December 15, 2003 Emails between Hawkins (ASCI) and Harvey (division) (discussing ASCI's experience with being sued when it had done nothing wrong, but saying nothing about whether it should be relieved of liability for third-party claims arising from its employees' errors); ASCI's January 2, 2004 letter (expressing concern about the amount of legal risk ASCI would bear under RFP Amendment 2, but saying nothing about a need or desire to limit ASCI's indemnity obligation to a select class of third party claims); January 6, 2004 Emails between Harvey (division) and Thompson (state's risk manager) (working up an RFP amendment to allow ASCI to use state contract forms and function as an agent of the state but saying nothing about treating contractor's employee errors as if errors by state employees).

51 ASCI's January 2, 2004 letter at p. 6, second and third bullets from the bottom.

ASCI was made an agent, not an employee, of the state. As such, the reasonable expectation was that ASCI would receive an agent's protection, not that of an employee. An agent's protection against liability is derived from the terms of the contract creating the agency relationship. Here, Article 1, Appendix B of the contract leaves ASCI liable to the state for third-party claims arising from errors by ASCI's employees.

ASCI was interested in negotiating relief from potential liability or defense costs for claims or lawsuits over matters "entirely within the State's control[]" or arising "solely out of actions of the State."[52] Its December 9, 2003 letter does not support the assertion that the parties contemplated treating some ASCI-employee errors as if committed by state's employees. The letter instead shows that ASCI recognized the purpose of the pilot project was to demonstrate savings through outsourcing the procurement function to a private sector contractor, not just by saving money on goods and services procured.[53] ASCI "concentrate[d] heavily in this letter … on requested changes that will foster the stimulation of innovation."[54] ASCI explained that the requested changes might be necessary to make the project "an economically justifiable undertaking for the private sector."[55] Nowhere in the eleven page letter did ASCI say that errors by the procurement contractor's employees would need to be treated as if made by a state employee before ASCI specifically, or a private-sector contractor generally, could undertake the project economically.[56]

In the letter ASCI did request that the state "extend its obligation to ***defend*** its actions and those of its Agents to include the good faith ***actions*** of the contractor …."[57] The letter said nothing about altering the indemnity requirement, nor did it equate "actions" to employee "errors." The context for this request was ASCI's concern about the Status of Contractor provisions, particularly a concern that the contractor would be required "to assume all liability for claims and dispute resolution arising from [its] procurement activities …."[58] ASCI expressed

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52 Affidavit of Barry Jackson at p. 3.

53 ASCI's December 9, 2003 letter at p. 1.

54 *Id*.

55 *Id*.

56 *See generally* ASCI's December 9, 2003 letter; *also* at p. 4 (discussing the need to be able to withdraw from the arrangement at the renewal stage because of the "potential for economic punishment" existing in the contract but not attributing that potential to employee errors); pp. 4-5 (discussing unknowable risks of the contract when requesting that the performance bond requirement be dropped but not saying anything about employee-error risk); p. 10 (requesting changes to "contract deficiencies clause" to give the contractor "reasonable opportunity to perform its obligations under the contract …" but saying nothing about how employee keypunch or other potentially commonplace errors should be addressed).

57 *Id*. at p. 5 (emphasis added).

58 *Id.*

concern that the state might exercise its "coercive power over the contractor regarding the methods, means, and requirements for making procurements[,]" thereby creating "uncontrollable, unlimited liability for the Contractor" and "attempting to outsource [the state's] contracting risk and associated legal liability …."[59] These negotiation points do not suggest ASCI was bargaining for an indemnity arrangement that would have the state bear the cost of errors by ASCI employees, or otherwise intended that "claims" for indemnity purposes would exclude claims based on such errors. ASCI may sincerely believe that it was negotiating for the state to cover the costs of some ASCI-employee errors and that such costs should not constitute "claims" under the indemnity provision, but the contract and the extrinsic evidence of the parties' pre-proposal communications do not support such a finding.

Had the parties so intended, they easily could have given "claims" a special technical meaning, unique to this contract's indemnity provision. For instance, they could have agreed that "claims" would not include a supplier's demand for payment of a restocking fee, a return freight charge or an amount less than a negotiated *de minimus*—e.g., $100. They did not. They could have agreed that, for purposes of ASCI's duty to indemnify the state, a supplier's demand for payment of any kind is not a "claim" unless the state disputes the demand or tenders the matter to ASCI, so that ASCI can dispute it, before it is paid. They did not do that either.

Because "claims" was given no special technical meaning, the indemnity provision must be interpreted using the plain language meaning of the word, in light of the contract's purpose and the goal of giving effect to the reasonable expectations of the parties. In its plain language noun form, "claim" means "a demand for something due or believed to be due[.]"[60] Thus, a supplier's demand for payment of a restocking fee is a "claim" in the ordinary sense. Apportioning responsibility based on whose error causes a demand for payment gives effect to one of the contract's purposes—saving public funds by using a private contractor to perform a function previously performed by government employees.[61] The indemnity provision in the contract executed by the parties reflects this choice, as well as the fact that ASCI (not the state) had the power to hire, train, supervise and fire its own employees. The reasonable expectations

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[59] *Id.* at pp. 5 & 6.

[60] *Merriam-Webster's Collegiate Dictionary* at p. 227 (11th ed. 2004); *also compare Black's Law Dictionary* at p. 264 (8th ed. 2004) (defining "claim" in the legal context as including "[a] demand for money, property, or a legal remedy …").

[61] *See* 2003 SLA, ch. 51, § 1 (listing among findings for the pilot project legislation the opportunity to achieve cost savings by using private sector specialists).

of the parties, as evidenced by the language used in the indemnity clause, were that each would be responsible for its own errors.

The indemnity provision does not make receipt of a formal claim (e.g., administrative contract claim or lawsuit) from the supplier a prerequisite for the demand to be treated as a "claim" for indemnity purposes. More likely than not the supplier was paid right away, perhaps in response to the initial invoice, well before it would have been necessary for the supplier to file an administrative or judicial claim.[62] In any event, under the contract's indemnity provision, the lack of a formal claim process or lawsuit does not establish that the supplier's payment demand was something other than a "claim."

The $189 restocking fee claim indisputably arose from the keypunch error by ASCI's employee.[63] This claim may be relatively trivial, but that does not change its nature as a third-party claim. Paying the fee rather than disputing the amount or the propriety of the supplier's decision to assess it probably was prudent because the amount was so small. Had the supplier attempted to charge $18,900 or $189,000, a dispute as to the reasonableness of the amount likely would have ensued, even if the error and the need for the supplier to restock the returned items were indisputable. If the dispute had not been resolved and the supplier had been forced to make a formal administrative claim or file a lawsuit, ASCI would have been liable under the indemnity provision for any award to the supplier. It also would have had to defend the state against the claim at ASCI's expense. The $189 claim by the supplier may have been paid before it matured into a full-blown dispute with the supplier, but it was a claim nonetheless within the meaning of the contract's Article 1, Appendix B indemnity provision.[64]

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[62] *See, e.g.*, Division's September 12, 2005 brief at p. 7 (explaining that the state paid the supplier before even discovering that an ASCI error had led to the restocking fee); ASCI's May 26, 2005 letter at p. 2 (noting that the state paid the restocking fee without dispute).

[63] At page 2 of its September 14, 2005 brief, ASCI argued that a subsequent restocking fee of approximately $800 was caused by a state employee submitting a duplicate order which ASCI was not able to cancel in time to avoid assessment of the fee. The parties have agreed that the subsequent fee is not within the scope of this decision. *See* Division's November 15, 2005 letter at p. 2 (explaining that it did not intend to address in this claim a subsequent $729.05 claim which it took to be the "nearly $800 for restocking fees" claim to which ASCI referred); ASCI's November 16, 2005 letter (agreeing with the division's position). This decision, therefore, expresses no opinion about liability for that subsequent restocking fee.

[64] The division's briefing acknowledges that the state paid the supplier before realizing ASCI had made an error and that if the state had withheld payment, forcing the supplier to make a claim, the claim would have been tendered to ASCI. Division's September 12, 2005 brief at p. 7. ASCI has not suggested that the $189 restocking fee was excessive or impermissible, nor has ASCI asserted that the division's failure to tender the matter to ASCI is a defense. Accordingly, this decision expresses no opinion about whether ASCI's liability for such charges under the indemnity provision is contingent upon ASCI being given the chance to dispute suppliers' claims for such fees before those claims are paid.

## IV. Conclusion

ASCI is liable for the $189 restocking fee, not because the indemnity provision requires ASCI to pay contract claims by the state, but because it requires ASCI to pay (or defend against) claims by third parties when caused by ASCI-employee errors. Had a dispute about whether the supplier's restocking fee claim was valid or reasonable erupted, ASCI would have been required not just to indemnify but also defend the state against the supplier's claim. ASCI has not asserted any affirmative defenses against enforcement of the indemnity obligation under the circumstances presented by this specific claim. Accordingly, ASCI must indemnify the state in the amount of $189.

DATED this 26th day of February, 2007.

By: *Signed*
Terry L. Thurbon
Chief Administrative Law Judge

## Adoption

This Order is issued under the authority of AS 36.30.675, AS 44.21.010 – AS 44.21.020, AS 44.17.010, and AS 44.64.030(c). The undersigned, on behalf of the Commissioner of Administration and in accordance with AS 36.30.675 and AS 44.64.060, adopts this Decision and Order as the final administrative determination in this matter.

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska R. App. P. 602(a)(2) within 30 days after the date of this decision.

DATED this 23rd day of March, 2007.

By: *Signed*
Terry L. Thurbon
Chief Administrative Law Judge

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