BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS ON REFERRAL BY THE COMMISSIONER OF TRANSPORTATION & PUBLIC FACILITIES

MILLER CONSTRUCTION CO., LTD.)
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v.)
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DEPARTMENT OF TRANSPORTATION &)
PUBLIC FACILITIES, SOUTHCOAST REGION) OAH No. 19-0088-CON

ORDER ON BUSINESS DESTRUCTION DAMAGES

Miller Construction has proved that the Southcoast Region breached its contract with Miller Construction for the construction of a road generally known as the Shelter Cove project. Miller Construction has alleged that because of the breach its business was destroyed. It values the damages due as a result of the destruction at $4,578,400.[1] The parties have requested an order on whether on this record Miller Construction can be awarded damages for the destruction of its business.[2]

A. Does the contract allow claims for consequential damages under §105-1.17?

The threshold question is whether the claims provision of the Standard Specifications, §105-1.17, permits an award of consequential damages. The Region quotes the following sentence in Subsection 1.17, which sets out that damages will be computed as a measure of the contractor's cost: "In computing damages, or costs claimed for a change order, or for any other claim against the Department for additional time, compensation or both, the contractor must establish actual damages based on internal costs for equipment, labor or efficiencies."[3] The

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1 Beaton testimony; Miller Construction Exhibit 7351-EE at 20.

2 For the reasons stated in Miller Construction's responsive brief, I reject the Region's argument that it is immune from claims for business destruction damages. *See* Miller Construction's Responsive Brief on Business Devastation at 2; *see also* AS 36.30; *cf. also State, Dep't of Nat'l Resources v. Transamerica Premier, Ins. Co.,* 856 P.2d 766, 776 (Alaska 1993) (holding that claim for business destruction against state may be pursued in administrative hearing on contract claim). Although I understand that the Region is asserting that this case is different than *Transamerica* because here the claim arises out of an alleged (albeit attenuated) interference with contract right, that argument is simply another way of arguing that the termination *caused* the business destruction. The issue of causation is discussed below.

By the same token, for the reasons discussed in the Region's Response Brief, I reject Miller Construction's argument that the Region waived arguments opposing business destruction damages by not discussing these arguments in the Contracting Officer's decision. These proceedings are *de novo* and that argument has no merit. *See* Region's Response Brief at 1-2.

3 SCR 330 at 35 (§105-1.17), *quoted in* Region's Response Brief at 8. The full paragraph in which this sentence is found states:

> If the Contractor believes additional compensation or time is warranted, the Contractor shall immediately begin keeping complete, accurate, and specific daily records concerning every detail of the potential claim including actual costs incurred, and shall give the Engineer access to any such records and furnish the Engineer copies, if requested.

Region then quotes the contractual definition of cost, which states, "[a]mounts actually incurred by the Contractor in the performance of the Contract that are (a) actually reflected in contemporaneously maintained accounting or other financial records and (b) supported by original source documentation."[4] The Region concludes that these two sections, read in concert, limit damage awards under Subsection 1.17 to costs incurred in the day-to-day implementation of the contract. In its view, the contract impliedly excludes all consequential damages because those damages arise from events or transactions outside the actual performance of the contract.

In Miller Construction's view, Subsection 1.17 does not limit the award of damages. First, Miller Construction argues that the limiting language Subsection 1.17 applies only to claims for "additional compensation."[5] Here, in its view, its claims seek damages for compensation due under the contract, not "additional" compensation. Therefore, it concludes, Subsection 1.17 does not limit its damage claim to costs, and certainly has no effect on its claim for consequential damages. Second, Miller Construction focuses on the word "establish," and argues that Subsection 1.17 merely establishes a threshold for being eligible for damages. Once a claimant has incurred actual damage, as proved by actual costs, it can then claim both direct damages and consequential damages, under any measure (not just a cost-based measure).[6] Miller Construction concludes that "MCC's damages for SCR's failure to properly compensate MCC for the extra work should not be limited or otherwise impacted by the language in Standard Specification 105-1.17."[7]

At the outset, I reject Miller Construction's broad interpretation. Miller Construction's grammatical argument is not well taken. The plain language of the sentence clearly applies to the prepositional phrase "in computing damages."[8] Grammatically, it is not limited to just damages

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> Equipment costs must be based on the Contractor's internal rates for ownership, depreciation, and operating expenses and not on published rental rates. In computing damages, or costs claimed for a change order, or for any other claim against the Department for additional time, compensation or both, the contractor must establish actual damages based on internal costs for equipment, labor or efficiencies. Total cost, modified total cost or jury verdict forms of presentation of damage claims are not permitted. Labor inefficiencies must be shown to actually have occurred and can be proven solely based on job records. Theoretical studies are not a permissible means of showing labor inefficiencies. Home office overhead will not be allowed as a component of any claim against the Department.

4 SCR 330 at 3 (§101-1.03), *quoted in* Region's Response Brief at 9.

5 Miller Construction Brief re Limitation on Damages at 3-4.

6 Miller Construction Response Brief on Quantum Meruit at 6-7 ("once the *existence* of actual damages is shown, MCC is free to *recover* damages based on any measure except for '[t]otal cost, modified total cost, or jury verdict forms.'" (emphasis in original)).

7 Miller Construction Brief re Limitation on Damages at 5.

8 SCR 330 at 35 (§105-1.17).

based on claims for additional compensation. Further the sentence does not say "to be eligible for damages" a contractor must establish damages based on costs. Moreover, the Alaska Supreme Court has interpreted this subsection to set out the method for *calculating* damages. As the court explained, "[t]he contract at issue here expressly provided for the actual cost method to calculate damages."[9] Thus, Miller Construction's argument that this subsection merely establishes a threshold eligibility standard has been rejected by the court.

We cannot, however, simply accept the Region's plain-language argument that Subsection 1.17 impliedly prohibits recovery for consequential damages. Although the Region is correct that, on its face, Subsection 1.17's limitation of damages to damages based on costs would apply to all damages, contract interpretation is not always simply a matter of accepting the plain meaning. The goal of contract interpretation is to identify the terms of the parties' agreement, and then enforce that agreement. This is not always so easy. Accordingly, courts have used rules of construction and drafting conventions that will sometimes lead to a conclusion that the parties' intent was a result that is not the same as that that would be dictated by strict adherence to plain language.

Here, the construction of Subsection 1.17 comes down to two questions. First, is there a general requirement that limitations on consequential damages be express rather than implied? Second, does the holding of *North Pacific Erectors* apply to consequential damages or is it limited to direct damages?

1. Is there a general requirement that limitations on consequential damages be express rather than implied?

The Region argues that Subsection 1.17 "does not distinguish between direct damages, consequential damages, or any other type of damages. Instead, it plainly and broadly applies to all claims for 'damages.'"[10] The Region cites to *Blacks Law Dictionary's* definition of "damages," which defines the term to include both direct and consequential damages, for support that consequential damages are simply a form of damages.

Although there are many subcategories of contract damages, in the well-known treatise on contracts called *Williston on Contracts*—a treatise relied on by the Alaska Supreme Court in *North Pacific Erectors* and by the Region in its brief—Professor Lord notes that "[t]here are two

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[9] *North Pac. Erectors, Inc. v. State, Dep't of Admin.,* 337 P.3d 495, 507 (Alaska 2013); *see also id.* at 506 ("the parties contracted to require detailed records for differing site condition claims and to establish the actual cost method as the only permissible method to calculate damages").

[10] SCR's Brief Regarding Subsection 105-1.17 at 9.

broad categories of contract damages: direct, or general, damages and consequential, or special, damages."[11] He explains that "general" damages are those "that flow naturally from a breach."[12] Consequential damages, on the other hand, are "not an invariable result of every breach." They are limited to foreseeable damages that arise "from some of the consequences or results of the breach." Accordingly, they are sometimes referred to as "special damages."[13]

This distinction does not shed much light on our problem here, but it does set the stage for a possible conclusion that the term "damages" might not always include both direct and consequential damages. In common parlance, people might use a term to refer to the general conditions encompassed by that term, without necessarily intending to include special conditions or circumstances. Given this distinction, therefore, a reference to "damages" might mean only general damages, not special damages.

The Region, however, cites to a section in the Williston treatise that discusses how a general limitation on damages on might affect consequential damages. In this section, Professor Lord notes that "[i]n determining the amount of consequential damages recoverable for breach of a contract, it is often necessary to consider any limitation of liability" because "contracting parties are generally allowed to limit their liability in the event of breach to the performance of certain prescribed acts, such as repairing or replacing any defective performance or parts, or to the payment of a specified sum."[14] He advises that "[t]he effect of such provisions, if lawful, may be to exclude entirely any liability for consequential damages."[15]

To the Region, that statement puts an end to this inquiry—it concludes that implied limitations on consequential damages are allowed, and that Subsection 1.17 therefore limits damages to those that are measurable by cost, which necessarily excludes liability for consequential damages. We cannot, however, jump so quickly to this conclusion. Professor Lord has only advised that the effect of the limitation provision *may* be to exclude liability for consequential damages—he said not said that it necessarily precludes consequential damages.[16]

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11 Richard A. Lord, 24 Williston on Contracts § 64:16, *Distinction between general and special damages* (4th ed.).
12 *Id.*
13 *Id.*
14 *Id.* at § 64:21.
15 *Id.*
16 *Id.* The two cases cited by Professor Lord as support for this conclusion are not helpful in determining the circumstances in which liability will be excluded. One of the cases involved an express limitation on consequential damages, which was held to extend to a subcontractor. *Costa v. Brait Builders Corp.,* 972 N.E.2d 449 (Mass. 2012). In the second case, the court held that a limitation on damages to repair of defective materials only applied if the

Moreover, in this same section of his treatise, Professor Lord also advises that "[e]xculpatory or limitation of damages clauses are ordinarily not favored, and must be strictly construed against the party in whose favor they operate." This is consistent with Alaska law.[17]

Given that the clause limiting damages to a cost-based remedy in Subsection 1.17 must be strictly construed, it follows that the Region's argument regarding the prohibition on "adding terms" may not be germane to this issue. In making this argument, the Region claims that excluding consequential damages from the reach of Subsection 1.17 requires inserting the adjective "direct" in front of the noun "damages." Otherwise, it says, "damages" must be read to mean "all damages."

I agree with the Region that the ALJ cannot add terms to the contract. That does not necessarily mean, however, that a finding that Subsection 1.17 does not preclude liability for consequential damages will require that the ALJ insert the word "direct" in front of the word "damages." Given that limitations on damages must be construed narrowly, the rules of construction allow the decisionmaker to conclude that the absence of an express application to consequential damages may mean that the limitation does not apply to consequential damages. Thus, the pen to preclude liability was in the Region's pocket. No insertion of extra words is required because the Regions' failure to include the appropriate words leads to the result.

The takeaway from this discussion is as follows. Although the sentence in Subsection 1.17 that gives a directive for what must be done "in computing damages" could be read to preclude consequential damages, that is not the only possible reading of the sentence. Given that the sentence must be strictly construed, it could be read to apply only to general (direct) damages. The ultimate inquiry is to focus on the parties' reasonable intent when they signed the contract. As the Alaska Supreme Court explained many years ago, "the appropriate standard to apply here is that of the reasonable expectation of the parties, i.e. 'the sense in which the party using the

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theory of recovery was based on materials being defective; liability for other claims, including a defective design claim, was not affected. *Lamell Lumber Corp. v. Newstress In.ern., Inc.,* 938 A.2d 1215 (Vt. 2007).

[17] *See, e.g., Uncle Joe's Inc. v. L.M. Berry & Co.,* 156 P.3d 1113, 1119 (Alaska 2007) ("We adopt the rule that exculpatory clauses in tariffs should be strictly construed against the utility and in favor of the customer because all the reasons for disfavoring such clauses in contracts also apply to tariffs."); *cf. also Dresser Indus., Inc. v. Foss Launch & Tug Co.,* 560 P.2d 393, 395 (Alaska 1977) ("We agree with the substantial authority requiring that provisions exempting a party from liability for the party's own negligence must be clearly set forth."); *Nelse Mortensen & Co. v. Group Health Co-op. of Puget Sound,* 566 P. 2d 560, 566-70 (Washington App. 1977) (listing Washington cases that narrowly construe limitations on contract remedies in construction contracts to apply only to what is expressly stated, and holding that delay damages are precluded only if expressly precluded).

words should reasonably have apprehended that they would be understood by the other party,' and the meaning which the recipient of the communication might reasonably have given to it."[18]

Applying this standard to the language of the contract, the sentence in question, as a limitation on damages, is somewhat murky. The point here is not that the sentence is ambiguous—under a careful and close reading, the plain language of the sentence would, indeed, convey the meaning that damages are to be measured by cost. The scope of that directive, however, is not clearly expressed.[19]

Moreover, the best evidence of the understanding of the parties can be found in another subsection of the contract—§108-1.09, the subsection that sets out the procedures for a claim for a termination for convenience. That subsection, like Subsection 1.17, contains an express requirement that damages be based on costs.[20] It also includes, however, an express exclusion of consequential damages from a claim: "[l]oss of anticipated profits or consequential or compensatory damages" are costs that "are not payable under a termination settlement agreement or Contracting Officer's determination of the termination claim, or on appeal."[21]

The express language of §108-1.09 is evidence that a reasonable person would not necessarily read Subsection 1.17 to preclude consequential damages. It is evidence that the Department did not consider an express limitation of damages to cost to be sufficient to convey to contractors that they could not make claims for consequential damages.

In addition, Miller Construction has come forward with an argument that Subsection 1.17 does not occupy the field for damages. It points out that some claims will necessarily require other forms of damages. For example, if a contractor prevailed upon a claim that it had completed a contract, when the owner had argued that more work was needed and withheld substantial sums, the contractor would be awarded contract-completion damages—not damages based on costs. Thus, Miller Construction reasons, there must a different path to damages that is

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18 *Day v. A & G Const. Co.,* 528 P.2d 440, 445 (Alaska 1974) (quoting 4 Williston, The Law of Contracts § 603 at 344 (3rd ed. 1961), and citing Restatement of Contracts § 227, Comment a(5) and a(6) (1932)).

19 To the extent that Subsection 1.17 is ambiguous, ambiguity in contracts can be construed against the drafter. In Alaska, however, "ambiguous contracts are construed against a party only 'in the absence of other means of ascertaining the reasonable expectations of the parties.'" *Zamarello v. Reges*, 321 P.3d 387, 392 (Alaska 2014) (citation omitted). Here, Miller Construction is a sophisticated party, fully capable of protecting its interests. Therefore, I will rely on other evidence of intent rather than simply construe Subsection 1.17 against the Region.

20 SCR 330 at 64 (§ 108-1.09) ("the claim may be for the total of: (1) costs incurred in performing the terminated work from the date of Contract award to the effective date of the termination.").

21 SCR 330 at 65. Although the Region argues that no court has ever awarded consequential damages after a termination for convenience, that argument goes nowhere. As discussed below in the section on causation, no one is proposing here that consequential damages be awarded under §108-1.09.

not controlled by Subsection 1.17. To Miller Construction, that means that the limitation of damages to costs in Subsection 1.17 applies only to claims for additional costs. Although I do not agree with Miller Construction's sweeping conclusion, I do agree that its argument that not all damages will be based on costs is further reason that a contractor would not necessarily conclude that Subsection 1.17 precluded a claim for consequential damages.

In short, Subsection 1.17 can be interpreted to apply to all damages or only direct damages. Here, I would accept extrinsic evidence of intent (other than statements of the parties) to construe how a reasonable person would interpret the subsection, and could be persuaded either way.[22] The evidence of intent, however, is limited. Therefore, I will rely on the sharp distinction between Subsection 1.17 and §108-1.09, and hold that, based on this comparison, the language of Subsection 1.17 does not communicate an intent to preclude an award of consequential damages.

This holding is subject to one caveat—if the Alaska Supreme Court has already ruled to the contrary, then, of course, the holding must be reversed. To answer that question requires a careful inquiry into the holding of *North Pacific Erectors.*[23]

2. Does the holding of *North Pacific Erectors* preclude an award of consequential damages under §105-1.17?

In *North Pacific Erectors,* the Alaska Supreme Court examined whether a contractor claiming damages for a differing site condition could pursue its claim even though the contractor failed to keep records of its costs. In ruling against the contractor, the court relied heavily on the strict language of Subsection 1.17 to conclude: "[t]hus, the parties contracted to require detailed records for differing site condition claims and to establish the actual cost method as the only permissible method to calculate damages."[24] The court further explained that "[t]he contract at issue here expressly provided for the actual cost method to calculate damages and prohibited the total cost, modified cost, and jury verdict methods."[25]

If the court intended for these broad statements to limit both consequential damages and direct damages in every case, then our inquiry here would be over—the requirement that all damages be calculated only by the actual cost method would preclude an award of consequential

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[22] Although Miller Construction has cited me to several statements it made in communications to the Region that it would seek business destruction damages if the Region were to destroy its business by shortpaying progress payments, I am not required to accept post-agreement statements of a party as evidence of the parties' intent at the time of entering into the agreement.

[23] 337 P.3d 495.

[24] *Id.* at 506.

[25] *Id.* at 507.

damages, even when a contractor has kept cost records and has established a claim for direct damages. Here, however, a different interpretation of *North Pacific Erectors* is just as plausible.

In *North Pacific Erectors,* the court was not addressing the circumstance of a contractor who had established a case for direct damages. It had in front of it a contractor who had no claim for direct damages. In that case, it made sense for the court to use broad language, applicable to both direct and consequential damages, for the contractor who had no claim for direct damages. Nothing in *North Pacific Erectors,* however, suggests that the court meant to prevent a contractor who had a claim for direct damages from pursuing a claim for consequential damages (to the extent such a claim was permitted by the contract).

The conclusion that the court did not intend to preclude consequential damages in all cases is slightly bolstered by the court's observation that its holding can be distinguished from an Illinois case that addressed consequential damages.[26] Although it is not clear precisely what the court meant when it distinguished the Illinois case, the fact that it noted the difference between limitations on consequential damages and limitations on damages due to record-keeping requirements suggests that the court did not intend for its holding to extend to all claims for consequential damages.

In sum, when a contractor has kept records and therefore has a claim for actual costs and direct damages under §105-1.17, that subsection does not impliedly exclude a claim for consequential damages that are caused by a breach of contract. Consequential damages, however, are notoriously difficult to prove and the common law of contract imposes several hurdles for a claimant to cross before being awarded damages for business destruction. Those hurdles are discussed next.

B. Was the destruction of Miller Construction's business caused by the Region's failure to make timely progress payments or by the wrongful termination?

The first hurdle that a party claiming consequential damages must pass is the issue of causation: Did the breach actually cause the business destruction?[27] The parties have addressed

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[26] *Id.* at 509 (distinguishing *Razor v. Hyundai Motor America,* 854 N.E.2d 607 (Ill. 2006), and noting that "While *Razor* involves the relationship between a consequential damages provision and a limited remedy clause, this case involves an express record-keeping requirement, and there were no allegations of unconscionability."). In *Razor,* the limitation on consequential damages in a warranty was found unconscionable when applied to a consumer. 854 N.E.2d. at 622-23. *North Pacific Erectors* declined to find that this precedent could be read to allow a court to ignore Subsection's 1.17's requirement that damages be based on actual costs. Nothing in the court's discussion of *Razor* directs the outcome here, but it does suggest that the court did not intend to address all claims for consequential damages.

[27] *See, e.g., Fairbanks N. Star Borough v. Kandik Const., Inc. & Assocs.,* 795 P.2d 793, 798 (Alaska 1990), *opinion vacated in part on other grounds,* 823 P.2d 632 (Alaska 1991) ("Recovery of damages for a breach of

the issue of causation on two levels. First, as a broad, macro issue, the parties disagree about whether the failure was caused by the Region's act of wrongfully terminating Miller Construction or by the Region's underpayment of progress payments. That question is important because, as explained above, under §108-1.09, if the cause was the termination, no business destruction damages will be allowed. This argument will be addressed in this section of this decision.

Second, at a more micro and nuanced level, the parties have debated what precise aspect of Miller Construction's business led to the catastrophic loss of value—was it something unusual within Miller Construction? Or was it a probable result for any small-to moderate-size construction company in these circumstances? That issue will be explored in the next section, where I address the issue of whether the collapse of the business was foreseeable.

With regard to the macro issue of whether it was the underpayment or the termination that caused the business to fail, the Region argues that the termination caused the business to lose value. In its view, only after it issued its initial notice of default did Miller Construction's surety revoke Miller Construction's bonding capacity. Without a bond, Miller Construction could not do additional work. Miller Construction admits that its loss of bonding capacity was what caused its loss of value.[28] Therefore, the Region concludes, the true cause of Miller Construction's loss of value was the default termination. To the Region, this means that the business-destruction damages are *termination* damages (claimable under §108-1.09), not claim damages (claimable under §105-1.17) based on wrongful withholding of progress payments.

Miller Construction, however, has proved that the lack of cash flow was a "but-for" cause of its failure. At the hearing, Toby Miller testified that Miller Construction was unable to finish the project because "we ran out of money."[29] The Region, in turn, has consistently stressed that its termination occurred only after Miller Construction had failed to timely finish the project.[30] Moreover, as the July 2020 proposed decision found, the road would have been substantially completed on time if the Region had paid more money and allowed additional time. Thus, even if the termination was the final event in the chain leading to the destruction of the business, had the

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contract is not allowed unless acceptable evidence demonstrates that the damages claimed resulted from and were caused by the breach." (quoting *Boyajian v. United States,* 191 Ct.Cl. 233, 423 F.2d 1231, 1235 (1970))).

[28] Miller Construction Initial Brief at 8 ("MCC might have been able to survive the millions of dollars in operating losses generated by SCR's underpayment on the Shelter Cove Road Project if MCC had not lost its bonding capacity.").

[29] Toby Miller testimony.

[30] *See, e.g.,* Region's Reply in Support of Motion to Establish Law of the Case at 3 (Nov. 5, 2019).

Region granted Miller Construction's July 2017 Request for Equitable Adjustment, Miller Construction's business would not have experienced a catastrophic loss in value.

Moreover, the evidence supports Miller Construction's view that the surety took action to suspend Miller Construction's bonding capacity because of concerns about Miller Construction's cash flow. For example, in a November 27, 2017, email, Miller Construction's bond broker explained, "Once the trends and outlook improve regarding the cashflow for Shelter Cove, and the projected ultimate gross margin, or loss, becomes more reliable, they will be able to make a better informed decision on what circumstances will potentially allow them to restore bonding for Miller, assuming cashflow improves and gross margin is not too heavily impacted at the end of the day."[31] In testimony, the broker explained that the trigger for analysis that led to the suspension of the bonding capacity was Miller Construction's request for a loan from the surety.[32] This is further evidence that it was the limited cash flow during the fall of 2017 that was the "but-for" cause of the alleged loss of value, not the termination.

Finally, Miller Construction has elected to value its loss as of November 2017.[33] As explained below, the decision to value the loss as of that date may make award of damages problematic. Because that valuation date precedes the termination, however, it is strong evidence that the termination was not the cause of the damages being claimed here.

The Region's second argument regarding causation argues that the shortfall in cash flows would not have caused a large asset-laden business like Miller Construction to go out of business. Therefore, it reasons, the cause must have been from some other source, such as Miller Construction's being undercapitalized. As explained below, this argument is better analyzed as a question of foreseeability.

C. Was it foreseeable at the time of contracting that a failure to make payments of this size would probably destroy Miller Construction's business?

Foremost among the limitations on consequential damages imposed by the common law of contract is the concept of foreseeability. Damages may not be awarded if the "party in breach did not have reason to foresee" the damages "as a probable result of the breach when the contract was made."[34] Damages are foreseeable, however, if they naturally followed from the breach for

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31 Miller Construction Ex. 2456.

32 Alderman testimony.

33 Miller Construction Ex. 7351-EE.

34 *Native Alaskan Reclamation and Pest Control, Inc v. United Bank Alaska,* 685 P.2d 1211, 1220 (Alaska 1984) (quoting Restatement (Second) of Contracts § 351 at 135 (1981)).

any entity in the claimant's shoes, or if the breaching party had reason to know of any special circumstances of the claimant that led to the damage.[35]

The Region argues that it did not have reason to foresee that Miller Construction would go out of business merely because it did not grant Miller Construction's July 2020 request for equitable adjustment. It cites to courts in other jurisdictions that have disallowed recovery for business-destruction damages when a company collapses after its bonding capacity has been curtailed.

The Region is correct that some courts have barred recovery for contractors in positions similar to Miller Construction's. In *Olin Jones Sands Company v. United States,* for example, the Court of Claims barred recovery for damages that "allegedly resulted when, because of defendant's actions, the bonding company or others refused to issue bonds on behalf of plaintiff on other contracts or work, thus crippling the contractor's ability to obtain new contracts or new work."[36] In the court's view, "[e]ven if proven, these damages would be too remote and speculative to be recoverable."[37] Based on my reading of this case, and the other cases cited by the Region, I conclude that if this dispute were governed by law in the federal or state jurisdictions cited by the Region, Miller Construction would not be able to seek damages for business destruction.

In Alaska, however, the court is not as hostile to claims based on lost bonding capacity. In *Geolar v. Gilbert/Commonwealth, Inc., of Michigan,* the Alaska Supreme Court held that it was "foreseeable that a claim would be made against Geolar's bonding company, resulting in a suit brought by the bonding company against Geolar and Geolar's inability to conduct business as a construction company."[38] Thus, in Alaska, there is no automatic bar to recovery for business-destruction damages based on a contractor's loss of bonding capacity.

The Region also argues, however, that the circumstances that led to the demise here were neither a natural result of the shortage in payment nor due to circumstances within its sphere of knowledge. In its view, Miller Construction was a robust construction company with considerable experience and $35 million in aggregate bonding capacity.[39] Pay disputes in construction projects are common. Here, the differential between Miller Construction's pay

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[35] *Id.*

[36] 225 Ct.Cl. 741, 743-44 (1980). Like the facts here, the contractor alleged that its bonding capacity was affected "because of the defendant's delay in making these contract payments." *Id.* at 743.

[37] *Id.* at 744

[38] 874 P.2d 937, 947 (Alaska 1994).

[39] Region Response Brief at 3.

requests and the amount paid by the Region ranged from $95,546 in June 2017 to $1,494,980 in November 2017.[40] The Region argues that an owner would expect that a construction company with that much bonding capacity could work through a cash flow shortage of this size.

The Region makes a good point. As Miller Construction's expert testified, construction companies must be able to weather financial storms.[41] Continuous cash flow is never certain. Jobs may be scarce because heavy civil construction in Southeast Alaska may wane for many years. Other companies might outbid Miller Construction. Bids may not always be profitable. Given the nature of the business, the Region does not expect a company to fail for lack of financial wherewithal. Bidders are required to give assurances of responsibility—meaning that they are sufficiently capitalized to see a project through difficult phases. And the Region's ability to foresee financial disaster for a company is influenced by the company's bond. The point is not that the bond is a backstop in case of disaster. The point is that the bond is an indication that an insurance broker has concluded that the company's fundamentals are sound, meaning that the Region would be less likely to foresee financial collapse as a probable result of short payments.

Moreover, the issue here is cash flow—as already discussed, the reason that Miller Construction was unable to finish the project was that it ran out of money. In theory, if it could have raised sufficient cash to keep working, it could have finished the project, and kept its bond rating (even though it would have been in debt until such time as its claims were sorted out).

Miller Construction was a healthy construction company. Its balance sheet shows that in November 2017 it owned tangible assets with a market value of $5,622,612.[42] Its borrowings against these assets (long-term debt, noncurrent) was only $2,585,013.[43] This appears to offer

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40 Proposed Decision at 95. Note that these figures are the unpaid portion of the pay requests submitted by Miller Construction. These pay requests were based on its costs. Yet, Miller Construction's balance sheet for November 2017 shows an accounts payable of $2,878,533 and an outstanding line of credit of $605,649. Miller Construction Ex. 7351-EE at Schedule 10. These debts total almost $3.5 million in short-term debt. To the extent that these debts were related to the Shelter Cove project, it suggests that the pay requests do not reflect all unpaid costs, meaning that the $1.5 million is likely an underestimate of Miller Construction's actual financial difficulties. For purposes of determining whether financial collapse was probable for a company in Miller Construction's position in November 2017, however, I will use the unpaid pay request data in September/October 2017. This amount is the shortfall for which Miller Construction was seeking financial assistance from the surety in fall 2017. This means that Miller Construction had concluded that it could finish the project, and avoid default, with funding of this amount. It follows that the appropriate question is whether it was foreseeable that Miller Construction's inability to bridge this gap at that time would lead to financial collapse. Of course, if the $2 million + additional short-term debt reflected in the balance sheet were to be from a source other than the Shelter Cove project, it would go a long way toward proving the Region's case that Miller Construction's financial collapse was neither caused by this project nor foreseeable. The Region has not, however, made that case.

41 Beaton testimony.

42 Miller Construction Ex. 7351-EE at Schedule 11.

43 *Id.*

mortgageable collateral for a loan. Although it had a mammoth accounts payable ($2,878,533) in November 2017, a reasonable person (foreseeing this situation at the time contracting) might expect that a longstanding company with valuable assets, run by savvy brothers with many contacts, would be able to procure sufficient financing in September or October 2017 to avoid ruin.

In reality, however, as this record shows, Miller Construction was not a prospect for a loan from a commercial lender in fall 2017. A responsible loan officer would consider Miller Construction's accounts payable, the Region's notice of intent to default, and the Region's declaration in the Kake project that Miller Construction was not a responsible bidder. Even with its valuable tangible assets and longstanding reputation, Miller Construction was too risky a bet.

The question, of course, is not where Miller Construction stood in November 2017. The question is whether the Region could have foreseen in May 2016 that its failure to recognize that Miller Construction had installed plan quantities by July 2017 would lead to Miller Construction's becoming too risky for a loan, and then to financial collapse. On this question, I have received very little guidance. The record contains little or no evidence on whether construction companies can generally be expected to survive a financial shortage of the size experienced by Miller Construction here, or whether financial collapse is probable under these circumstances. I see both sides of the issue very clearly, and understand how the scenario might have been foreseeable, and how it might not.

I resolve this conundrum in favor of Miller Construction because courts have consistently recognized and advised of the risk of withholding progress payments.[44] Here, the Region knew, or should have known, that short paying progress payments would cause financial distress. When the size of the short payment reached one million dollars, that debt, combined with the other costs necessarily incurred by a construction company to finance a project of this size, made it probable that the company would need a sizeable source of additional financing to finish the project and avoid default. It was also probable that when funding for one project was being wrongfully

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[44] *Cf., e.g., Arctic Contractors., Inc. v. State,* 564 P.2d 30, 43 (Alaska 1977) ("a building contract is a credit transaction. The builder is risking his labor and materials on the promise of the other party to pay an agreed price therefor in specified instalments. The amount of his investment, the extent of the credit that must be given, and the amount of risk involved are all increased if performance must go on after a payment has failed." (quoting 3A Corbin, contracts § 692 at 269-271 (1960))), *limited on other grounds by Native Alaskan Reclamation,* 685 P.2d at 1219. In limiting the holding of *Arctic Contractors, Native Alaskan Reclamation* addressed the issue of the proper test for foreseeability, commenting that "[in] *Arctic Contractors, Inc. v. State,* 564 P.2d 30, 44–45 (Alaska 1977), this court, in dicta, recommended the *Hadley* rule, but mentioned Justice Holmes' 'tacit agreement' test in a footnote." 685 P.2d at 1219. The upshot of this discussion was to make the foreseeability test somewhat less demanding than it had been in the day of the "tacit agreement test."

withheld from a company, the company would be deemed nonresponsible to bid on other projects. That would make it ineligible for additional for additional work, and, likely, not a good financing risk. Finally, it was probable that its surety would revoke its bonding capacity until the company had sufficient cash flow to pay its bills. Therefore, the Region could have foreseen that wrongful denial of progress payments on this scale would probably lead to business failure, and recovery of business destruction damages is not barred by the foreseeability principle.

D. Has Miller Construction proved the amount of its damages were reasonably certain?

Damages in contract law must be proved with "reasonable certainty."[45] In *Geolar,* for example, the Alaska Supreme Court reversed a jury award of damages for business destruction because the claimant had not proved the amount of the damage with reasonable certainty.[46]

Miller Construction has alleged that it suffered $4,578,400 in loss of value of its business due to the Region's breach. To support this claim, Miller Construction presented the testimony and report of business valuation expert Neil J. Beaton. Mr. Beaton valued the company as a going concern in November 2015 at $4,578,400. He valued the company as having no value in November 2017.[47] He concluded that the entire value of the business was lost.

The Region argues that Miller Construction has not proved its damages. In particular, it argues that Miller Construction's claim in this proceedings has considerable value.[48] In its view, that refutes Mr. Beaton's assertion that Miller Construction had no value in November 2017.

In calculating the value of the business in November 2015, Mr. Beaton used two valuation processes. First, he used the income method. To do this estimate, he projected Miller Construction's expected future cash flow based on three years, 2013-15, and an expected growth rate for pre-tax earnings. He then capitalized these projected earnings to determine an actual value in November 2015 of $3,094,200.[49]

Second, Mr. Beaton used the market method. This approach determines the likely sales price of the company if it had been sold in 2015. To make this estimate, Mr. Barton looked at two sets of comparable sales—stock sales of comparable construction companies that are publicly traded, and sales of privately-held comparable construction companies. He then computed

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45 *Native Alaskan Reclamation*, 685 P.2d at 1222 (quoting Restatement (Second) of Contracts § 352 at 144 (1981)).
46 *Geolar,* 874 P.2d at 947.
47 Beaton testimony.
48 Region Response Brief at 5.
49 Beaton testimony; Miller Construction Ex. 7351-EE at Schedule 3.

statistics from these sales that would allow him to reach a reasonable estimate of Miller Construction's sales value. He blended the two values (relying 80 percent on the methodology for privately-held companies) to arrive at a projected sales price of $4,578,400.[50]

In presenting his conclusion of value, Mr. Beaton relied solely on the market approach. He rejected the income approach because, he explained, it did not capture full value. In his view, it represented what Miller Construction would earn going forward if it were to rent out the business, rather than sell it. It failed to capture the actual sales premium that would be paid if Miller Construction had been sold in 2015.[51]

Mr. Beaton's final task was to estimate the value of Miller Construction in November 2017. This value would be subtracted from the 2015 value to arrive at the dollar value lost when the business failed. For this task, he was forced to use the cost approach to value. He could not use the income approach because Miller Construction, having gone out of business due to its inability to procure a bond, did not have any prospect of future income. He could not use the market approach, he explained, because "no one's going to buy a company that's not generating any revenue and has a deficit equity of $1.25 million dollars."[52] Given that Miller Construction's balance sheet showed a negative value (i.e., its liabilities significantly outweighed its assets), Mr. Beaton concluded that Miller Construction had no value by November 2017.[53] Because the company had no value, he did not need to deduct post-event value from pre-event value. Instead, he testified that the entire pre-event market value, $4,578,400, was a reasonable estimate of Miller Construction's business destruction damages.[54]

Mr. Beaton's approach, however, runs directly into the *Geolar* problem. In *Geolar*, the court rejected the valuation because the company's expert did not value the sales value of the company's equipment after the company went out of business.[55] The court explained that to support compensable damages, a valuation must deduct the defunct company's residual net value, including the value its assets would bring at a sale held after the company was forced out of business.[56]

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50 Beaton testimony; Miller Construction Ex. 7351-EE at Schedules 4-9.
51 Beaton testimony.
52 *Id.*
53 *Id.*
54 *Id.*
55 874 P.2d at 947.
56 *Id.*

Here, Mr. Beaton attempted to avoid the *Geolar* issue by testifying that there was no market for Miller Construction's fixed assets. He explained that after a failure, the market would "look for to the company to shut down and buy the equipment at scrap prices. . . . The vultures wait around for the company to demise and it happens and they pick up these assets at pennies on the dollar."[57]

There are several problems with this testimony. First, vultures or no, the equipment had some value. As stated above, Miller Construction's tangible assets had a market value of $5,622,612.[58] This equipment had some sales value and that value must be deducted from Mr. Beaton's estimate of market value before damages can be awarded.[59]

To the extent that Miller Construction is arguing that it can avoid making a deduction for the sales value of the assets because its balance sheet showed a negative value (which arguably could mean that the proceeds from the asset sale would be absorbed by the liabilities), that argument does not work. If we are using the balance sheet to value Miller Construction as of November 2017, then the Region is correct that we must add to the balance sheet the value of Miller Construction's claim against the Region. As we now know, that claim has considerable value. That positive asset would cancel out the loss from the liabilities.[60]

Finally, the market approach here is fundamentally flawed because it was not supported by sufficient evidence. Here, Mr. Beaton is asking that we assume that a viable market existed in 2015 for a medium-sized civil construction company located in an isolated area—Southeast Alaska. In his view, the market would be willing to pay a premium over the capitalized cash-flow value of the company. He does not discount the value for any concern that some of its value may reside in the expertise of the two brothers who run the company, even though they may not

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[57] Beaton testimony.

[58] Miller Construction Ex. 7351-EE at Schedule 11.

[59] Ms. Skaife and other Miller witnesses testified that Miller Construction lost its equipment in a "fire sale" after it went out of business. But Mr. Beaton's valuation was as of November 2017, before any fire sale occurred. Furthermore, even a fire sale of over $5 million dollars of valuable equipment would yield a nontrivial positive amount. In addition, if we address Ms. Skaife's testimony that the fire sale was a cause of the damage (apparently caused in part by the loans on the equipment being overdue), it might raise new concerns about the foreseeability of the damage (an issue avoided by Mr. Beaton's valuation being dated November 2017). In sum, the fire-sale issue would not make Mr. Beaton's testimony about the market approach to valuation a reasonably certain measure of damage.

[60] I disagree, however, with the Region's assertion that we must use the (corrected post-hearing) balance sheet for the post-event valuation of Miller Construction. Business destruction damages are separate from the sorting out of Miller Construction's 2017 accounts payable and accounts receivable that will occur in this proceeding. My points here are that (1) the tangible assets had a post-event sales value in November 2017 that must be deducted from its pre-event value; and (2) Miller Construction cannot use the (uncorrected pre-hearing) November 2017 balance-sheet liabilities to absorb that value because those liabilities are being sorted out in this proceeding independent of the business-destruction damages.

continue long with the company after the sale. He does not discount the value for any difference between a company located in Juneau versus a company located in Anchorage or the lower 48. Apparently, Mr. Beaton's testimony about the 2015 value relies upon assumptions regarding a near-perfect market—one with competition among buyers, information exchange, and low transaction costs. These assumptions may be correct, but to make his theory viable, evidence would have to be marshalled that these theories would apply to the specific facts of Miller Construction.

In contrast, when Mr. Beaton gets to November 2017, he now asks us to posit the complete absence of a viable market. The hypothetical buyer who was willing to take the risk of acquiring Miller Construction in 2015 now will not buy it because, in Mr. Beaton's view, Miller Construction has no earning capacity. Yet, Mr. Beaton has not explained why the well-capitalized hypothetical buyer (who wanted the company in 2015) could not buy the company (at a discounted price) in 2017 without assuming its liabilities, obtain a bond (based on the buyer's capital), and use the company to generate income. Moreover, his testimony assumes that the "vultures" who will pick up the company at pennies on the dollar are not subject to market forces of competition and, therefore, can obtain arbitrage profits without other vultures bidding up the price. Again, these assumptions may be accurate and applicable, but the contrast between the near perfect market assumed in 2015 and the absence of market forces in 2017 is so inconsistent that considerable evidence would have to be presented for Mr. Beaton's market valuation to be a reasonably certain measure of value. Therefore, Miller Construction has not proved with reasonable certainty that it suffered business destruction damages of $4,578,400.

Mr. Beaton's income approach, on the hand, is not subject to these same theoretical concerns. That approach makes the assumption that Miller Construction will not generate income for its owners after 2017. That assumption is correct (adjusted by the timing distinction that, because it prevailed in part in these proceedings, it will, eventually, have a corrected balance sheet that shows that it generated income *in* 2017). Therefore, the income approach appears to be a reasonably certain method for valuing Miller Construction as of November 2015.

Under *Geolar,* however, even accepting that the income approach is a reasonable pre-event valuation, a correction would have to be made for the post-event sales value of Miller Construction's assets. Without that correction, even the apparently-acceptable valuation from the income approach is not a reasonably certain measure of damages.

Because the parties' focus has been on the market approach, I am unable to say whether Miller Construction can come forward with evidence in this record to support a reasonable post-event valuation of its tangible assets. In addition, I note that the Region's expert, Mr. Seibold, was critical of Mr. Beaton's income approach. The Region has not fleshed these arguments out, Miller Construction has not responded to them, and I have not delved into them.

Therefore, at this time, I will not affirm or reject the income approach. As we proceed with the damages case, the parties can agree to a valuation based on the income approach (or agree that this record does not support such a valuation), or they can present additional arguments regarding whether, on this record, damages have been proved with reasonable certainty.[61]

DATED: September 10, 2021.

By: [redacted]
Stephen Slotnick
Administrative Law Judge

Certificate of Service: I certify that on September 10, 2021, a copy of this document was distributed by email to: Jesse O. Franklin IV (by email); Allen R. Benson (by email); Garth Schlemlein (by email); Laurel Barton (by email); Tess Keeley (by email); Max D. Garner (by email); Chris A. Robison (by email); Patricia Runyan (by email); Leilani J. Tufaga (by email); Christina M. Fisher (by email); Dep't of Law central email (by email). A courtesy copy was also sent to Hilary Porter (by email) and Christopher M. Kennedy, ALJ (by email).

By: [redacted]
Office of Administrative Hearings

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[61] To be clear, I have not yet given indepth consideration to Mr. Seibold's criticisms of the income approach, in part because the parties would need to flesh out these issues with citations to governing case law (which the parties have not done because the focus was on Mr. Beaton's market approach). Before the parties spend too much time on this task, however, they should be aware that *Native Alaskan Reclamation* requires that "[d]oubts are generally resolved against the party in breach." 685 P.2d at 1222 (quoting Restatement (Second) of Contracts §352, Comment (a) (1981). Applying this standard, my preliminary review indicates that, although Mr. Seibold's criticisms do indeed sow some seeds of doubt, the pre-event valuation based on the income approach appears reasonable, and likely can be adopted.

A more critical task will be determining whether this record contains reliable evidence of the post-event value of Miller Construction's assets as of November 2017. As required by *Geolar*, I will not award damages if the record does not provide a reasonably certain methodology to account for the post-event sales value of Miller Construction's assets as of November 2017. 874 P.2d at 947. Under *Native Alaskan Reclamation*, my standard for evaluating a post-event valuation will be lenient (and I am less troubled by the assumption that the post-event market will not be robust in this case where I am not being asked to assume the pre-event presence of a competitive market). Still, a reasonable non-zero post-event value for the assets not based on unwarranted speculation must be proved or recovery will be denied. I do not intend to reopen the record on this issue.