

STATE OF CALIFORNIA
STATE WATER RESOURCES CONTROL BOARD

In the Matter of the Petition of)
RUSSIAN RIVER COUNTY SANITATION)
DISTRICT)

ORDER NO. WQ 90-4-CWP

For Review of a Determination of)
the Division of Clean Water)
Programs, State Water Resources)
Control Board Regarding)
Grant Funding for Legal Costs)
Related to a Construction Claim.)
Our File No. G-114.)

BY THE BOARD:

The Russian River County Sanitation District (District), seeks grant funding for certain legal, technical, and administrative costs incurred by the District in defending a claim asserted against it by its engineering consultant, Montgomery Engineers (Montgomery). The District also seeks funding for certain legal, technical, and administrative costs it incurred in pursuing claims it asserted against Montgomery for design deficiencies, against Hanson and Armco, the manufacturer and supplier, respectively, of the pipe used for the project, and against the all-risk insurance carriers on the job. More specifically, the District seeks 87½ percent grant funding¹ for the \$557,400 it expended for the foregoing items.

For the reasons hereafter stated, we conclude that the District should be provided with grant funding for the legal, technical, and administrative costs it incurred in defending and

¹ This represents 75 percent federal and 12½ percent state funding.

prosecuting the claims at issue in an amount not to exceed the funds remaining in its grant, Clean Water Grant No. C-06-1088-120.

I. BACKGROUND

Federal Regulations (40 C.F.R. Part 35, Subpart I, Appendix A) provide that costs of defending against a contractor's claim are unallowable for grant funding unless certain conditions are met. Five conditions must be met for grant funding of costs associated with enforcement of claims by the grantee. These five plus one more must also be met in order to fund costs of defending against contractor claims. The conditions are:

1. The claim must arise from work within the scope of the grant.
2. A formal grant amendment must be executed specifically covering the costs before they are incurred.
3. The claims must not be settleable without arbitration or litigation.
4. The claim must not arise from the grantee's mismanagement.
5. The Regional Administrator must determine there is a significant federal interest in the issues involved in the claim.
6. In the case of defending against a contractor claim, the claim must not result from the grantee's responsibility for the improper action of others.

The District was awarded an EPA grant on September 20, 1977 for construction of a treatment plant, disposal facilities and a collection system. A matching state grant followed. Construction of the project began in 1979. Soon after construction began in 1979, the contractor had difficulty reaching the required compaction for backfill over the PVC pipes. The difficulty occurred because the native soil had a relative density below that required by the specifications. Saturated clay and large redwood stumps were also encountered in various areas of the pipeline project. In 1981, the District terminated its contract with the contractor, Caputo-Wagner, because Caputo-Wagner refused to correct certain "dips and bellies" in the collection system. Caputo-Wagner contended that the "dips and bellies" were the result of differing site conditions, while the District initially contended that they were the result of faulty construction on the part of Caputo-Wagner.

Caputo-Wagner filed a claim against the District for more than \$22 million. That claim was ultimately the subject of litigation. Settlement negotiations between the District and Caputo-Wagner began in January of 1982 and continued until October of the same year. Caputo-Wagner's claim was finally settled for \$4.4 million (the first settlement). The Division found the entire \$4.4 million to be grant eligible on the basis that the costs arose from a differing site condition. The Division also provided funding for the legal, technical, and administrative costs associated with that settlement. The District had insufficient funds available to it to pay its local

share of the settlement with Caputo-Wagner. Caputo-Wagner, as part of the first settlement, agreed to accept an assignment of the District's right to recover for claims the District had against its engineers, its all-risk insurance carriers, and its pipe manufacturers and suppliers. Both the Division and the District agree that these claims arise from items which were ineligible for grant funding. The District was not required to return any portion of any funds recovered by way of these claims to the grant funding agencies.

These claims were finally settled in a manner whereby the District received a total sum of \$2,850,000 (the second settlement); \$550,000 of which was paid to Caputo-Wagner and represented final payment of the District's local share of its settlement with Caputo-Wagner.

It is the legal, technical, and administrative costs incurred by the District in reaching this second settlement which is the subject of this petition. These costs amount to a total of \$557,400.

There are only \$103,071 in total eligible dollars currently left in the District's state and federal grants. That means that the actual grant dollars available to the District are 87.5 percent of the \$103,071 or \$90,187.

Therefore, the amount of grant funding requested by the District exceeds the available funds remaining in its grant.

After considering the matter at various levels of review, the Division issued a Final Division Decision on January 31, 1989, denying funding for the costs requested on the

basis that they were not eligible for grant funding under applicable EPA regulations and guidelines. This petition followed.

The Board designated two Board members to represent it at an informal meeting between the Division and the District. That meeting was held on October 31, 1989.

The two Board members have recommended that the costs at issue in this appeal be funded to the extent that funds remain available in the District's current grant.

II. CONTENTIONS AND FINDINGS

1. The District contends that the work which generated the costs at issue was within the scope of the grant because its settlement with its construction contractor (which was within the scope of the grant) required it to pursue the remaining parties and without the second settlement, the first settlement would not have occurred.

The Division contends that EPA guidance, which indicates that "within the scope of the grant" means "the eligible portion of the grantee's construction program", should be applied to preclude recovery in a case such as this one where the underlying costs of the settlement relate to ineligible items.

We find that to the extent that the first settlement required the District to pursue the second settlement, condition number one has been complied with. However, since the second settlement resulted in a recovery which exceeded the funds needed for the District's local share of the first settlement, we find

that only those costs of achieving the second settlement which were related to recovery of the \$550,000 needed to pay Caputo-Wagner under the first settlement were within the scope of the grant. A ratio of 550/2850, about 19.3 percent, of grant funding for the \$557,400 (approximately \$107,569) should be used to determine those costs which were "within the scope of the grant".

2. The District contends that application of EPA's rule requiring grantor approval prior to incurring defense and prosecution costs is an impermissible retroactive application of EPA requirements, and should not act as a bar to recovery.

The Division concurs that application of the rule cannot be applied to the District. However, the Division points out that EPA rules applicable to this grant (40 C.F.R. § 35.935-11(a)(1)(iv)) have always provided that costs which will increase the amount of grant funding needed for a project require prior written approval.

We find that full payment of the costs in question would require a grant increase, and that the District failed to get prior approval as required. Therefore, to the extent that a grant increase would be required to fund the costs at issue, EPA rules requiring written approval before incurring costs which will increase the grant amount preclude the Board from granting the relief requested. The State Board can provide funding up to the amount of funds remaining in the District's current grant, however, and we find that such funding should be provided under the circumstances of this case.

3. Both the District and the Division concur that the claim could not have been settled without arbitration or litigation.

4. The District contends that the underlying claims in the second settlement did not result from grantee mismanagement. The Division contends that had the project been properly managed the claims would not have arisen.

We find that the Division has not established that there was grantee mismanagement. Therefore, the District is correct in its contention that there was no grantee mismanagement.

5. The District contends that there is a federal interest in the settlement because the District could not have settled the first claim without recovery from the second settlement. The District further contends there was a federal interest in the first settlement since it resulted in a reduction of the contractor's initial claim of \$22 million to a settlement of \$4,400,000.

The Division contends that there is no federal interest in the second settlement because that settlement was used in part to raise the District's local share of the first settlement and because the second settlement was totally attributable to ineligible items.

EPA has not clearly defined what it meant by the federal interest. In the absence of definitive guidance, we find that there was a federal interest in reaching the second settlement, at least to the extent that the settlement proceeds

were used to pay the District's obligations under the first settlement. As indicated above, however, the pro rata share of costs attributable to recovery of the amount necessary to complete the first settlement (\$107,569) exceeds the remaining amount available under the current grant (\$90,187). Therefore, recovery should be limited to the funds remaining in the current grant.

6. The District contends that the claims arising under the second settlement did not result from its responsibility for the improper actions of others.

The Division contends that the District's failure to properly manage its contracts resulted in the additional costs which Montgomery sought from the District causing the District to incur costs to defend itself against the Montgomery claim.

We find that the claim by Montgomery against the District did not result from the District's responsibility for the improper actions of others.

III. SUMMARY AND CONCLUSIONS

1. EPA regulations allow funding for legal, technical, and administrative costs associated with defending against contractor claims or prosecuting claims to enforce subagreements.

2. Five conditions must be met in order to fund costs associated with enforcement of claims by the grantee. These five plus one more must be met in order to fund costs of defending against contractor claims.

3. Approximately 19.3 percent (550,000/2,850,000) of the \$557,400 requested arises from work within the scope of the grant.

4. Prior written approval is required before incurring costs which will increase the amount of grant funds needed.

5. Funding of the full costs at issue here would require a grant increase.

6. The District failed to get prior approval before incurring the costs at issue.

7. The underlying claims could not have been settled without arbitration or litigation.

8. The underlying claims did not result from the District's mismanagement.

9. There is a significant federal interest in the issues involved in the underlying claims in this matter, to the extent that settlement proceeds were used to pay the District's obligations under the previous, grant eligible settlement.

10. The District's need to defend itself against Montgomery's claim did not arise from the District's responsibility for the improper actions of others.

IV. ORDER

IT IS THEREFORE ORDERED that the District's appeal requesting eligibility for its costs in defending and prosecuting the construction claims at issue in this appeal be granted to the extent that it relates to the first settlement and to the extent that there are funds remaining in its current grant, Clean Water Grant No. C-06-1088-120.

CERTIFICATION


The undersigned, Administrative Assistant to the Board, does hereby certify that the foregoing is a full, true, and correct copy of an order duly and regularly adopted at a meeting of the State Water Resources Control Board held on July 19, 1990.

AYE: W. Don Maughan
 Darlene E. Ruiz
 Eliseo M. Samaniego
 John Caffrey

NO: None

ABSENT: Edwin H. Finster

ABSTAIN: None


Maureen Marche
Administrative Assistant
to the Board