

SUBJECT: Revising dispute resolution of certain contract claims against the state

COMMITTEE: State Affairs — favorable, without amendment

VOTE: 8 ayes — Swinford, Miller, B. Cook, Farrar, J. Keffer, Martinez Fischer, Villarreal, Wong

0 nays

1 absent — Gattis

WITNESSES: For — George Baldwin, Texas Building Branch - Associated General Contractors; Brent Bertrand, Dynamic Systems, Inc.; James Carchedi, Hydra Graphics; Steve Nelson, Texas Surety Federation; Joe Nixon

Against — None

On — Delmar L. Cain, Texas A&M University System; Cathleen Parsley, Renee Rusch, State Office of Administrative Hearings

BACKGROUND: Government Code, ch. 2260 establishes administrative procedures for resolving contract disputes between state agencies and their private contractors. The procedures in ch. 2260 are the exclusive remedy for contractors unless the Legislature gives consent to sue the state under Civil Practice and Remedies Code, ch. 107.

Ch. 2260 requires contractors to make claims to the agency within 180 days of a breach. The agency must begin negotiation of a claim within 60 days of the date the claim is received, the date of the contract's termination, or the completion date in the original contract, whichever is later. However, the agency may delay negotiation until after the 180th day of the event giving rise to the claim. The contractor and agency must negotiate regarding the dispute for at least 270 days. If a contractor is not satisfied with the result of the negotiation, the contractor may request a contested case hearing before the State Office of Administrative Hearings (SOAH), where an administrative law judge hears the case and makes a finding as to whether the contractor has a valid claim. A decision in this hearing may not be appealed, nor may a state agency change the finding of fact or conclusion of law or modify an order.

If the claim is valid and is worth less than \$250,000, the agency must pay the claim out of money appropriated to it for contested claims or for payment of the contract that is the subject of the claim. If a valid claim is worth \$250,000 or more, the hearing officer must submit a report and recommendations to the Legislature on whether to pay the claim and whether to allow the contractor to sue under Civil Practice and Remedies Code, ch. 107.

Sec. 2260.003 limits damages to the balance due on the contract price plus the fair market value of orders or requests for additional work to the extent that work was performed. An award may not include consequential or similar damages, exemplary damages, damages based on an unjust enrichment theory, attorney's fees, or home office overhead.

DIGEST:

HB 1940 would allow an award for a state contract dispute to include consequential damages, attorney's fees, and any delay or labor-related expense incurred by the contractor as a result of the state agency or a party acting under the supervision or control of the agency. An agency would be required to pay the full claim if the award was less than 25 percent of the original contract price as adjusted by approved change orders. If a claim exceeded 25 percent of the contract price, the agency would be required to pay that portion of the claim up to 25 percent of the contract price.

The bill would shorten the dispute resolution process by:

- changing from 90 days to 60 days the amount of time an agency had to assert a counterclaim against a contractor;
- requiring the negotiation to begin within 60 days of a claim being received;
- removing the ability of an agency to delay negotiation until after the 180th day of the event giving rise to the claim; and
- changing the amount of time the parties had to agree to mediate a claim from 270 days to 90 days after a claim was received.

The bill also would:

- allow a contested case hearing to be appealed for abuse of discretion; and
- specify that a contractor sued by an agency could assert a counterclaim or right of offset against the agency.

The bill would take effect September 1, 2005, and would apply only to contracts entered into on or after that date.

**SUPPORTERS
SAY:**

HB 1940 would bring fairness to the state's contract dispute resolution process and ensure that the state receives the best value possible in its contracts.

The contract dispute resolution system is unfair and burdensome for contractors. Under the current system, state agencies have an incentive to stall negotiations for as long as possible in order to discourage contractors from bringing claims. This tendency to delay is exacerbated by the extraordinarily long period in which state agencies have to respond to claims and begin negotiations. If a contract dispute arises early in the contract period, the agency has the option of waiting until 60 days after the contract is terminated or the original contract would have ended. Consequently, a year or more may pass before negotiations even begin on a dispute. The agency then has another 270 days before the contractor is allowed to request a hearing by SOAH. As a result, many companies have been unable to afford to pursue a contract dispute. HB 1940 would streamline the process by reducing the amount of time an agency had to respond to a claim and to negotiate the dispute.

The current system also prohibits a contractor from recovering attorney's fees or costs related to a delay in a project that results from a contract dispute. It is unfair for a contractor to be required to absorb these costs that it never would have incurred if it had not taken the contract, or had to dispute that contract, with the state. Moreover, contractors with relatively small disputes often are discouraged from pursuing a claim since the cost of the attorney's fees would be more than the potential award. By ensuring that contractors could recover these costs, HB 1940 would create a more level playing field and guarantee that contractors were not unfairly penalized when a state agency breached a contract. The bill also would allow a contractor to receive a portion of an award when the award exceeded the statutory cap, rather than requiring the contractor to further wait for the Legislature to act on the entire award. Only the amount in excess of the cap would have to be considered by the Legislature.

Creating a fairer contract dispute resolution process would enable the state to procure the best value contracts possible and reduce the overall cost to the state. Many qualified businesses have been deterred from bidding for state contracts because of concerns about how a contract dispute would be

resolved. Other businesses have inflated their projected costs in order to cover the anticipated cost of a contract dispute. Revising the dispute resolution process would encourage more businesses to compete for state contracts and would allow for lower contract bid amounts. By creating an environment in which public and private entities have a greater incentive to cooperate, the bill could result in fewer contract disputes. Finally, the bill could reduce the total amount of awards because contractors would be able to recoup only 25 percent of the contract amount directly from the agency, which for many small contracts could be less than the current \$250,000 limit.

The bill would not impose attorney's fees on a contractor whose claim was invalid because current statute already gives an administrative law judge the discretion to impose all of SOAH's fees on a contractor whose claim did not prevail. This provision is adequate to protect against frivolous claims.

**OPPONENTS
SAY:**

By allowing contractors to recoup attorney's fees and removing the \$250,000 cap on damages, the bill could create a more contentious and costly dispute resolution process. Allowing contractors to receive an award of up to 25 percent of the contract amount would encourage those contractors with particularly large contracts to pursue their contract disputes in order to receive a large payout. When these larger awards are combined with the ability to recoup attorney's fees, the result could be an enormous incentive to involve attorneys in the process and press for greater awards. Moreover, it would be inappropriate to allow a contractor to receive attorney's fees without imposing a similar requirement on a contractor that the contractor pay the state's attorney-related fees if a claim was found to be invalid in order to discourage frivolous claims.

**OTHER
OPPONENTS
SAY:**

HB 1940 would not address what is perhaps the most egregious problem in the contract dispute resolution process - the fact that agencies may avoid payment of an award by claiming that they do not have any funds available for that purpose. SOAH has no authority to investigate whether an agency is capable of paying, nor is it able to enforce its awards. A company should not have to go through the lengthy and onerous dispute resolution process only to have the agency avoid payment at the last moment. At a minimum, the bill should be amended to give SOAH the authority to determine whether an agency had the funds available for payment.

NOTES: The companion bill, SB 507 by Wentworth, has been referred to the Senate State Affairs Committee.