

**SUBCONTRACT PENALTY**

Issued: November 16, 1998

DOT&amp;PF Chief Contracts Officer: Mark O'Brien

Under **AS 36.30.115, Subcontractors for construction contracts**, direction is given on replacing a listed subcontractor and penalties that may be applied when a bidder violates provisions of this statute. The purpose behind **AS 36.30.115** is to encourage and stimulate competition, give a fair and equal opportunity to all prospective subcontract vendors, to assure that all qualifying vendors have the opportunity to bid, and to provide a deterrent to bid shopping.

Bid shopping can take various forms: after obtaining a contract, a successful bidder could play off one potential subcontractor against another in the hope of driving down the cost of subcontracting; the successful bidder could use phony subcontract bids to drive down the price; or the successful bidder could use its economic leverage or superior bargaining position to take advantage of an individual subcontractor.

**AS 36.30.115. Subcontractors for construction contracts.**

- (a) Within five working days after the identification of the apparent low bidder for a construction contract, the apparent low bidder shall submit a list of the subcontractors the bidder proposes to use in the performance of the construction contract. The list must include the name and location of the place of business for each subcontractor, evidence of each subcontractor's valid Alaska business license, and evidence of each subcontractor's registration under AS 08.18. If a subcontractor on the list did not have a valid Alaska business license and a valid certificate of registration under AS 08.18 at the time the bid was opened, the bidder may not use the subcontractor in the performance of the contract, and shall replace the subcontractor with a subcontractor who had a valid Alaska business license and a valid certificate of registration under AS 08.18 at the time the bid was opened.
- (b) The apparent low bidder for a construction contract may replace a listed subcontractor if the subcontractor:
- (1) fails to comply with AS 08.18;
  - (2) files for bankruptcy or becomes insolvent;
  - (3) fails to execute a contract with the bidder involving performance of the work for which the subcontractor was listed and the bidder acted in good faith;
  - (4) fails to obtain bonding;
  - (5) fails to obtain insurance acceptable to the state;
  - (6) fails to perform the contract with the bidder involving work for which the subcontractor was listed;
  - (7) must be substituted in order for the prime contractor to satisfy required state and federal affirmative action requirements;
  - (8) refuses to agree or abide with the bidder's labor agreement; or
  - (9) is determined by the procurement officer not to be a responsible subcontractor.
- (c) If a bidder for a construction contract fails to list a subcontractor or lists more than one subcontractor for the same portion of work and the value of that work is in excess of half of one percent of the total bid, the bidder shall be considered to have agreed to perform that portion of work without the use of a subcontractor and to have represented the bidder to be qualified to perform that work.
- (d) A bidder for a construction contract who attempts to circumvent the requirements of this section by listing as a subcontractor another contractor who, in turn, sublets the majority of the work required under the contract violates this section.
- (e) If a construction contract is awarded to a bidder who violates this section, the procurement officer may:
- (1) cancel the contract; or
  - (2) after notice and a hearing, assess a penalty on the bidder in an amount that does not exceed 10 percent of the value of the subcontract at issue.

(See Page 3 of this Bulletin for Distribution List)

<sup>1</sup> **CONTRACT OFFICER BULLETINS** - From time to time, it is expedient to issue information, guidance, or directives on certain construction contract matters. Such communications can best be accomplished through the medium of 'bulletins'. These bulletins are "interpretive" in nature and serve to inform and direct. They reflect the departments' policy on the issue being addressed. If a conflict between a bulletin and a statute or a formally adopted regulation is found to exist, the law/regulation takes precedence (ref. **AS 44.62.640(a)(3)**).

The DOT&PF has, on at least one occasion, gone beyond the contracting (a.k.a. procurement) officer's "hearing" to the formal appeals stage (ref: Bethel Highway Project No. 57119 - August 8, 1990 <sup>2</sup>) to achieve a determination on a violation of the subcontractor statute. The appeals hearing officer in the Bethel matter found that a fine should be applied, but reduced the contracting officer's assigned penalty from 10% to 5%, and associated the penalty with limited items of the bid. Subsequently, in the final department decision, the DOT&PF Appeals Officer lowered the penalty to 2 1/2 %. These actions show that inherent difficulties can be encountered in establishing a penalty amount when a violation is found to have indeed occurred. This is due to the varied circumstances and discovered facts of each case - the final adjudication will always be one of a certain degree of subjectivity.

In the Bethel matter, the hearing officer acknowledged that, *"The Contracting Officer has broad discretion in assessing a penalty for violations of the subcontractor statute. DOT&PF, however, has not adopted any guidelines or regulations setting forth how that discretion is to be exercised."* This bulletin sets out to provide that guidance and attempts to achieve regional consistency in such matters.

After careful review, it is determined that it is best to leave the current review/determination structure as now exists largely in place. The contracting officer will continue to make the initial determination of violation and penalty, but now has guidance by virtue of this bulletin, on how to perform the review and how to move towards assessing an appropriate penalty when a violation is found to have occurred.

### **FINDING OF PENALTY AND PENALTY ASSESSMENT**

In the event of possible noncompliance with **AS 36.30.115**, the contracting officer shall consider the imposition of such sanction(s) as may be reasonably determined after a thorough fact finding process.

A decision to assess a penalty is appropriate only when the findings of fact shows that a reasonable person would conclude a violation occurred, and that the penalty assessed for that violation was commensurate with the facts and the harm suffered.

The process for the contracting officer to work through in determining if a violation occurred and whether a penalty should be assessed is best conducted in at least three stages of review.

#### **FINDING OF PENALTY**

**Stage I** - Collect all initial information to determine if further, more detailed investigation is needed in order to make a conclusionary finding on whether a subcontractor violation has occurred. If there is no evidence of a violation, the process may be concluded at this stage.

**Stage II** - When preliminary investigations reveal a probability that a subcontractor violation has occurred, a more thorough examination and collection of the facts should be conducted. This step may also involve the preliminary interview of the principal players. If this investigation concludes that no violation occurred, the matter is closed. If findings indicate that a subcontractor violation occurred, the inquiry necessarily proceeds to **Stage III**, the contracting officer hearing.

**Stage III** - Remember, the contractor is to be afforded the opportunity to rebut allegations of a violation with either oral or written comments to the contracting officer, in accordance with **AS 36.30.115** <sup>3</sup>. When a violation of the statute is found to have occurred, a penalty may be assessed.

After the hearing, the contracting officer shall determine if the contract should be cancelled or if a penalty based on the percentage of the value of the subcontract at issue should be applied. The amount of the penalty may be up to 10% of the value of the subcontract at issue (**AS 36.30.115** allows for the imposition of a sliding penalty, i.e. from 0% to 10%). The amount of the penalty turns on the facts presented in each case - and there may be mitigating circumstances why a 10% penalty would be unfair. The following guidance should be useful in that determination:

---

<sup>2</sup> Copies of the Department's determination on the Bethel Highway appeal are available upon request by contacting Jim Beeson at 465-6965, Fax 586-4010.

<sup>3</sup> Common sense dictates that the hearing be held promptly, and with impartiality and fairness - though more expansive in scope than is required at this level of hearing, the contracting officer may find it helpful to review the document titled "Hearing Officer Guidelines, 1995 Edition", to form an understanding of the hearing process, especially as occurs at the appeals stage.

**PENALTY ASSESSMENT**

**No Violation** - No penalty assessment is to be applied.

**A Violation is Found to Exist** - When the contracting officer concludes, after a hearing, that a violation of **AS 36.30.115** occurred, the "penalty phase" is then addressed. The contracting officer has discretionary authority to decide the amount of the penalty. The penalty assessment should be closely tied to the attempt to circumvent the statute and to the magnitude of harm that resulted from the contractor's actions.

- **Minor Penalty (0 - 4%)** - When it is evident the violation was due to poor planning or over-optimism on the contractors' part, a corrective action may include nothing more than the issuance of a cure notice to the contractor. In a practical sense, though a penalty could be applied, it may be more expedient to issue a notice of violation but refrain from the assessment of a penalty beyond that of a written warning. This is particularly true if the action was in the state's interest. Always document actions taken with a written report (see Report/Records below).

If the contracting officer determines that circumstances warrant a minor penalty, such as a repeat occurrence or where the action may have caused minor damages to another subcontractor or the state, the penalty should be no more than 4% of the value of the subcontract at issue.

- **Moderate Penalty (5 - 7%)** - When the contractor may have realized a moderate economic benefit, at the expense of other subcontractors or the state, a more substantial penalty may be appropriate. Make sure to fully document the potential or actual harm that was conveyed to the state or to another subcontractor as a consequence of the contractor's actions.
- **Substantial Penalty (8 - 10%)** - When it is evident from the facts and the hearing record that the contractor intentionally violated **AS 36.30.115** in an effort to benefit economically at the expense of other subcontractors or the state, a more substantial penalty may be assessed. Make sure to fully document the potential or actual harm that was conveyed to the state or to another subcontractor as a consequence of the contractor's actions

**APPEALS**

The contracting officer's decision can be appealed to the DOT&PF Commissioner under **AS 36.30.625 - 630** - and on to judicial appeal under **AS 36.30.685**. Therefore, the contracting officer's decision should be complete and always well documented.

**REPORTS / RECORDS**

After each review and/or hearing of a possible subcontractor penalty violation, a "Lesson Learned" report should be generated to the DOT&PF Chief Contracts Officer. This report is to provide observations and suggestions deemed useful in the conduct of future evaluations of possible subcontractor violations, and shall be submitted no later than thirty (30) days following the completion of the review or hearing. The results of these decisions will be helpful for, and used in providing additional future guidance to the regions.

**INDEX OF PREVIOUSLY ISSUED BULLETINS**

<b>Bulletin No.</b>	<b>Title</b>	<b>Date Issued</b>
N/A	N/A	N/A

**DISTRIBUTION LIST FOR BULLETIN NO. 98-001**

Mike Downing, Director, Statewide Design & Engineering Services

*DOTPF Regional Directors*

Bob Martin, Southeast Region  
Tony Johansen, Northern Region  
John Horn, Central Region

*DOTPF Regional Preconstruction Engineers*

Pat Kemp, Southeast Region  
Steve VanHorn, Central Region  
Dave McCaleb, Northern Region

*DOTPF Regional Construction/Operations Directors*

Gary Hayden, Southeast Region  
Ralph Swarthout, Northern Region  
Dave Eberle, Central Region  
Chris Kepler, Central Region  
Gene Kulawik, Central Region

*Other Recipients*

Bob Doll, Alaska Marine Highways  
Donn Ketner, Anch. Int'l Airport  
Steve Flodin, Bldgs., D & C, Central Region  
Greg Young, Statewide Procurement  
DOT&PF, PSA Coordinators  
Sister Agencies  
John Celmer, Parsons Brinkerhoff, c/o Central Reg Dir's Office