AMERICAN DISPUTE RESOLUTION CENTER

CASE # 29 111 04

METROPOLITAN DISTRICT
COMMISSION

V.

CONNECTICUT RESOURCES
RECOVERY AUTHORITY

July 29, 2005

FINAL RULING ON MERITS OF REMAINING CLAIMS
AND COUNTERCLAIM

Procedural History

In 1999 CRRA submitted to a panel of arbitrators ("the Eagan panel") a claim that the MDC had been overcharging it under the terms of a 1984 contract for the operation of a solid waste disposal project known as the Mid-Connecticut Project. The Eagan panel issued a ruling dated May 19, 2000. In its ruling, the Eagan panel noted that the parties had initially agreed to a method for allocation of indirect costs (the "Pannell, Kerr & Foster" or "PKF" method) that had worked well in the beginning but that soon began to result in substantial overcharges to CRRA. The Agreement provides that CRRA is to pay MDC the "actual cost of the goods and services provided" (Article IV), including not only direct costs but "indirect costs (such as allocation of District personnel time)" that result to the MDC from its provision of workers and services to operate the Mid-Connecticut Project. The Agreement further provides that the MDC is not to have a financial interest in the Project. (Article VIII (l)(C)) and that all payments by the CRRA are to be applied only to expenses of the Mid-Connecticut project, not to other MDC projects. (Article V (6)).

After hearing evidence of an audit of indirect costs prepared by CRRA in 1998, as well as other evidence concerning claimed overcharging, the Eagan panel concluded that "it is clear to the panel that the indirect cost allocation system, as it currently operates, is unfair to CRRA. The panel, however, does not have sufficient evidence to determine by what amounts the Pannell methodology has in the past, or currently, over charges (sic) CRRA." Eagan Panel Decision, pp. 3-4. The panel directed the parties to agree upon a new methodology and instructed the parties to return for an adjudication if they were unable to agree. The Eagan panel found that MDC had indications since 1993 that the PKF method was resulting in overcharges; however, it stated that

> This panel does not have sufficient information to determine when MDC had an obligation to be pro-active and advise CRRA that the indirect cost methodology should have been changed. The panel believes on the current state of the evidence, that CRRA may be entitled to some credit for the continued use of the Pannell indirect cost methodology after MDC came to doubt its continued efficacy. The panel believes the fairest approach is to hear further evidence concerning the timing and the amount of any credit owed by MDC to CRRA on this issue and on any claim asserted by MDC.

Eagan Panel Decision, p. 5. The Eagan panel noted that it might need further expert evidence "on the issue of how indirect costs should have been computed retroactively and on the issue of the indirect cost methodology to be used on a going forward basis." Id. at n. 1

The parties failed to reach an agreement either on a new method for determining indirect costs or on the issue of credits for past overcharges. A member of the Eagan panel resigned, and the present panel was formed by the parties when the MDC raised claims that CRRA had breached the agreement by replacing MDC as the operator of and provider of transportation for several transfer stations. MDC filed several other claims but has stated that only Claims 7, 8 and 9 remain to be adjudicated. MDC stated that claim 12 is not to be adjudicated in this arbitration but may be claimed for adjudication in some subsequent proceeding.

On June 16, 2004, when the panel asked it to file a pleading delineating the claims it had raised to the Eagan panel, CRRA renewed the issue that had been left partly unresolved by that panel. CRRA filed a counterclaim alleging that MDC had breached its covenant of good faith and fair dealing with regard to its charges to the MDC under the Agreement. CRRA claims that it has been overcharged for indirect costs each year since 1993, and it seeks a remedy for the alleged overcharges, including prospective relief and interest. CRRA also filed defenses to MDC's Claims 7, 8, and 9 alleging MDC's failure to mitigate damages, prior breach by MDC, waiver, estoppel, and ratification.

MDC has filed defenses to the counterclaim. In a prior ruling, this panel rejected the defense of lack of arbitral jurisdiction. The remaining defenses are the expiration of the statute of limitation, waiver, the unavailability of damages under the Agreement, the doctrines of unclean hands, equitable estoppel, unjust enrichment, a contractual deadline for raising billing disputes, and laches.

A. MDC's Claims

After a hearing conducted in March 2005, the panel rules as follows on the remaining claims of MDC:

1. Claim 7

"Is the refusal of CRRA to pay the MDC bill of December 19, 2000 in the amount of $468,354.62 for supplemental direct costs incurred for the months of January through June 2000 a violation of the terms of the Agreement, including implemental agreements executed by both parties, and by the Decision?"

CRRA does not dispute the amount of the claim nor that the expenditures are a valid direct cost incurred by MDC for motor vehicle expenses and allocable to CRRA. The Agreement requires CRRA to pay MDC its direct costs of providing services to CRRA. CRRA asserts that this direct cost should not be awarded because MDC failed to include this amount in timely fashion in the budget process for each fiscal year. The Agreement specifies a process for formulating and adjusting each year's budget, based on costs projected by MDC; however, the Agreement does not explicitly bar recovery of any direct costs submitted after the expiration of the fiscal year in which they were incurred. The panel finds that CRRA has violated the agreement by failing to pay this sum and that MDC is entitled to recover $468,354.62. In view of our further findings, however, this amount, like the amount due under Claim 8, shall be applied as a reduction from any overcharges to CRRA.

The panel finds that the special defenses to this claim were not proven.

2. Claim 8

"Is the refusal by CRRA to pay an MDC bill presently in the amount of $2,703.268.90 to cover employee medical insurance costs for the approximate period of October 1999 through June 2002 a violation of the terms of the Agreement including implemental agreements executed by both parties, and the Decision?"

CRRA does not dispute that the sum claimed represents expenditures for health care costs incurred by employees allocable to CRRA, nor does CRRA dispute the amount of the claim. Medical expenses incurred by employees assigned to the Mid-Connecticut Project are direct costs under the Agreement. The Agreement requires CRRA to pay MDC its direct costs of providing services to CRRA. CRRA asserts that this direct cost should not be awarded because MDC failed to include this amount in timely fashion in the budget process for the years in which the expenses were incurred. We find that the amounts claimed were included in the budgets for the applicable years and that they were set forth in documents provided to CRRA, though no separate invoice was issued as to these costs.

The Agreement specifies a process for formulating and adjusting each year's budget, based on costs projected by MDC. The Agreement does not bar recovery of any direct costs submitted after the expiration of the fiscal year in which they were incurred. The panel finds that CRRA has violated the agreement by failing to pay this sum and that MDC is entitled to recover $2,703.268.90 from CRRA. Again, it is appropriate to treat the failure to pay for this direct cost as an offset against any claims for overcharges for indirect costs because the Agreement requires CRRA to pay only "actual costs" and because the Agreement contemplates credits where costs turn out to be different from the budgeted amounts. (Article IV(2)).

The panel finds that the special defenses to this claim were not proven.

3. Claim 9

"Is the refusal by CRRA to pay the costs including back pay associated with the termination of MDC employees Watkins, Rodriguez, Winkeler and Stevens a violation of the terms of the Agreement including implemental agreements executed by both parties and the Decision?"

The Agreement provides, at Article V, Sec. 4, that the MDC has the sole right to manage its personnel assigned to Mid-Connecticut functions and the sole right to discharge its employees. This section further provides that in the event that CRRA requires MDC to discharge an employee, CRRA "will indemnify the District of any costs thereof, including but not limited to back pay, if such action is reversed by a competent tribunal." The MDC's discharge of the listed employees was reversed by a grievance arbitrator and the MDC, after pursuing an application to vacate one of the arbitration awards, settled the claims of the employees for back pay and other damages arising from the discharges.

The evidence established that the discharges at issue were not requested or "required" by CRRA, and though CRRA did not object to the MDC's decisions to terminate the employees, the terminations represented exercises of the MDC's sole discretion, as did the litigation strategy and settlement of the claims after the MDC lost the grievance arbitrations.

Article V specifically limits MDC's right to indemnification for damages arising from discharges of its employees to those instances in which CRRA has required MDC to take action. MDC claims that a general term of the Agreement, Article VIII, requires CRRA to indemnify it regardless of the limitation stated in Article V.

We find that the limitation of the specific indemnification right with regard to employment actions must be given effect. No term of a contract is to be treated as surplusage, Lar-Rob Bus Corp. v. Fairfield, 170 Conn. 397, 407 (1976); A. M. Larson Co. v. Lawlor Ins. Agency, Inc., 153 Conn. 618, 621-22 (1966). Article V clearly limits the MDC's right to indemnification with regard to employment liabilities to those employment actions required by CRRA. To apply the general indemnification provision set forth in Article VIII would be to disregard the distinction to which the parties agreed in the specific terms of Article V and to render it meaningless. Connecticut Co. v. Divison 425, 147 Conn. 608, 617 (1960)("Every provision of the contract must be given effect if it can reasonably be done, because parties ordinarily do not insert meaningless provisions in their agreements.") See also Ceci v. National Indemnity Co., 225 Conn. 165, 175-76 (1993).

We find that MDC is not entitled to indemnification from CRRA for the expenses it incurred with regard to its exercise of its discretion to discharge and then settle the claims of these MDC employees.

B. CRRA's Counterclaim

CRRA claimed in April 1999 that MDC was breaching the covenant of good faith and fair dealing by overcharging MDC for indirect costs. CRRA repeated that claim when it filed a counterclaim to MDC's claims.

"Every contract carries an implied covenant of good faith and fair dealing requiring that neither party do anything that will injure the right of the other to receive the benefits of the agreement." Gupta v. New Britain General Hospital, 239 Conn. 574, 598

(1996). The Restatement (Second) of Contracts, Sec. 205, which has been cited with approval by the Connecticut Supreme Court in Warner v. Konover, 210 Conn. 150, 154 (1989), construes this duty as requiring performance that is faithful to an agreed common purpose and consistent with the justified expectations of the other party.

The parties to the Agreement at issue had the common purpose of operating a waste recovery and disposal plant on financial terms that would result in CRRA paying only the actual costs incurred by the MDC for that project, without subsidizing MDC's other projects.

The merits of the CRRA's claim were partly adjudicated by the Eagan panel in its 2000 ruling. The Eagan panel found that the manner in which MDC was calculating indirect costs was resulting in overcharges to CRRA, but it lacked sufficient evidence to determine either the amount of the past overcharges or the appropriate remedy. That panel ordered CRRA to pay MDC only seventy-five percent of the indirect charges for which MDC billed it under the PKF method. That panel ordered that the remaining twenty-five percent of the amounts charged be placed in a separate interest-bearing escrow account. In the event that the actual direct or indirect costs due were found to be greater than the seventy-percent MDC had received, MDC would be entitled to recover the additional amounts from the escrow. In the event that no additional amounts were due to MDC, CRRA would retain the escrowed amounts and would be saved from having continued to overpay while the dispute was being resolved.

The Eagan panel stated, in the passage cited above, that CRRA would be able to receive credits in the event of findings of past overpayments.

During the interval between the issuance of the ruling of the Eagan panel in May 2000 and the inception of the present arbitration proceedings, MDC continued to use the PKF approach to calculating indirect costs. MDC alleges that it had no obligation to change its method until CRRA suggested another method. This argument is not persuasive. The Agreement imposed on the MDC a duty to charge CRRA only for its actual costs, and it did not require CRRA to supply the method for arriving at the actual costs, since the voluminous and highly detailed information concerning MDC's expenses was in the possession of the MDC. The ruling of the Eagan panel put MDC on notice of the need to reform its method of charging CRRA.

Even if CRRA had made greater attempts to suggest an alternative model, it would not have been able to get access to the financial data needed to do so. Though MDC wrote to CRRA after the Eagan panel's decision to suggest that the parties start to assess the method, in fact MDC lacked any actual ability to do that until 2002 because it had installed a new computer system in late 1999 that was functioning so poorly that MDC was unable to access the cost data that an analysis by CRRA would have required. MDC's invitations to CRRA to discuss a new approach were, moreover, tied to statements that CRRA should help pay for MDC's faulty new $15 million computer system.

Between May 2000 and the date of CRRA's reiteration of its counterclaim in 2004, MDC did not present CRRA with any suggested new method for calculating indirect costs. Instead, it continued to bill according to the PKF method that had been identified by the Eagan panel as probably being unfair, but it unilaterally reduced its billings for indirect costs by one million dollars for a three-year period. That amount is

far less than the amount that the MDC's own expert has identified as the amount of overcharges for the three-year period.

MDC rejected a proposal by CRRA, made on June 26, 2001, to remedy the unfairness of the PKF calculations by applying an across-the-board reduction of twenty-five percent, even though MDC lacked the ability even to apply the PKF method based on current conditions. The PKF method was based on calculation of a "general overhead rate" or "GOR," and for the years 2000, 2001 and 2002, MDC 's computer problems prevented it from being able to calculate the GOR, so its billings were based on the 1999 GOR even though MDC was performing fewer functions for CRRA from 2000 on.

In 2003 the parties jointly retained the accounting firm of Deloitte & Touche, which did an abbreviated analysis that again confirmed that MDC was overcharging CRRA for indirect costs. MDC capped its billing for indirect costs at $2,874,000, but CRRA maintained, and MDC's trial expert confirmed, that this amount still constituted an overcharge.

At the hearing before this panel, the parties incorporated by reference the testimony before the Eagan panel and presented witnesses concerning the calculation of indirect costs and expert testimony concerning the appropriateness of the charges.

That testimony establishes that the MDC knew as early as 1993, when John Zimmerman, an MDC employee, did an analysis of the billings to CRRA, that it was overcharging CRRA for indirect costs. Over the ensuing years, MDC's internal communications reveal that it was aware that instead of being revenue neutral, its charges to CRRA were subsidizing its sewer and water functions.

The amount of the overcharges was the subject of expert testimony.

The MDC's expert witness, Basil A. Imburgia, a certified public accountant employed by FTI Consulting, Inc., concluded that for the period from June 1, 2000 through December 31, 2004, MDC overcharged CRRA for indirect costs by $1,736,735. Mr. Imburgia did not perform his own calculations of the indirect charges billed to CRRA by MDC between 1993 and June 1, 2000, however, he adopted a calculation performed by MDC employee John Zimmerman indicating overcharges of $2,628,685 for that additional period.

CRRA presented the analysis and testimony of Christopher Barry, a certified public accountant employed by PriceWaterhouseCoopers. Mr. Barry calculated that MDC had overcharged CRRA $17,292,290 for the 1993-2004 period. He noted that part of that amount is being held in the escrow ordered by the Eagan panel, and that CRRA has actually paid MDC $12,747,101 in excess of "actual costs" for indirect services over that period.

CRRA has demonstrated that from 1993 to date MDC has breached its duty of good faith and fair dealing by charging indirect costs by a method that it knew did not reflect actual costs but that overstated those costs in a manner that shifted to CRRA's customers some of the expenses of MDC's sewer and water operations.

Although CRRA has proven its counterclaim, the amount of the overcharges and the remedy for them must be determined in the context of applicable defenses. That calculation is set forth below.

a. Impact of defenses

MDC has not established its special defenses of waiver and laches. CRRA raised its claim in the arbitration before the Eagan panel, consistently treated it as a pending matter, and maintained it when this panel was formed after the disbanding of the Eagan panel and after unsuccessful attempts to mediate the disputes.

The issue raised is not a "billing dispute" of the kind subject to the requirements and limitations set forth in Article IV (3) of the Agreement. That section sets forth a method only for resolving disputes over individual items that arise in the course of a budget year, not systemic issues concerning the basis for arriving at whole categories of costs. These defenses are therefore rejected.

Two of MDC's defenses do, however, limit the relief to which CRRA is entitled.

CRRA acknowledged that its claim of breach of the covenant of good faith and fair dealing, though it identifies a principle of contract construction, is a tort, and it is subject to the three-year statute of limitation applicable to tort claims. Conn. Gen. Stat. Sec. 52-577. Since CRRA initially raised the issue of overcharges for indirect costs in April 1999, its claims for credits for overpayments for 1993, 1994, 1995, and the first three months of 1996 are barred.

The other applicable defense is the provision in the Agreement, at Article VI, which provides that in the event the MDC breaches the Agreement, CRRA is limited to the remedy of specific performance and no arbitration decision shall "result in the District owing any monies to the Authority regardless of fault." (Article VI (2)). This limitation on the remedies available to CRRA was no doubt the reason the Eagan panel provided for an escrow, so that delay in addressing the issue of overcharges would not result in payment by CRRA of unrecoverable excessive charges.

Though MDC cannot be ordered to pay damages to CRRA, it can be ordered to specifically perform its contract obligations. It assumed the obligation not to charge CRRA more than its actual costs. It agreed to give CRRA credits in the event of overcharges. (Article IV (2)). Though the latter provision is set forth in a section of the Agreement that addresses only the annual billing adjustments, it provides some evidence of the intent of the parties that the MDC was not entitled simply to retain more money than it was actually owed. While the contract language cited above means that MDC cannot be ordered to pay CRRA an amount of money for all the overcharges it collected, it can be ordered to offset the amount of its own claims in order to perform its duty to collect only the actual costs, both direct and indirect, of its services to CRRA.

Thus, the CRRA's remedies for the breach identified are limited to a) prospective relief in the form of an order of specific performance of the agreement to charge and collect from CRRA only the actual costs incurred by the MDC in connection with the Mid-Connecticut Project, including only the actual indirect costs and b) credits for overcharges paid from April 1996 to date against the direct costs owed by CRRA to MDC pursuant to the findings as to Claims 7 and 8 above.

Prospective relief is discussed below.

The credits due for overcharges are as follows. We have arrived at these figures by using the calculations of CRRA's expert witness, Mr. Barry, of the accounting firm PriceWaterhouse Coopers, as to 2000 - 2004, as we find his reasoning and calculations persuasive for this time period. With regard to earlier years, we find that he has somewhat overstated the overpayments by ascribing too low percentages to two types of

indirect costs: finance administration and financial control. Before 2000, MDC was supplying substantially more services to CRRA, and we believe that Mr. Barry's calculations, though valid for the later period of diminished services, require adjustment for April 1996-December1999. We have recalculated the amounts due by allocating twenty percent of the costs of finance administration and finance control to CRRA for 1996 through 1999. The figures set forth as overpayments do not include the amounts placed in escrow but only the actual amounts paid by CRRA to MDC for indirect costs. (Pursuant to an agreement with the parties, on June 30, 2005 we circulated a draft in which the calculations were based on an across-the-board reduction of Mr. Barry's calculations of 3.65%. MDC properly pointed out that since the expert had not arrived at these calculations on the basis of applying a percentage to direct costs for indirect costs, this reduction was flawed. On the basis of that comment, we instead recalculated the indirect costs as explained above.)

Overpayment for Indirect Costs		Additional Direct Costs Owed for Medical Expense	Additional Direct Costs for Veh.Maint.	Net amount of Overpayments
1996	$ 1,214,579 (nine months)			
1997	1,511,564			
1998	1,507,845			
1999	718,748			
2000	571,970			
2001	603,590			
2002	470,210			
2003	442,948			
2004	50,387			
TOTAL	$7,091,841			
		-$2,703,269	-$468,354	$3,920,218

The findings set forth above establish that even after reductions for the amounts of direct charges owed by CRRA pursuant to our rulings on Claims 7 and 8, MDC has overcharged CRRA for indirect charges in the amount of $3,920,218 and is not entitled to any additional funds for either direct or indirect charges out of the escrowed funds. The overpayments resulted even after the Eagan panel reduced the amounts actually paid to MDC by 25%.

The escrow account is not, as MDC urges, a fund out of which it must be compensated for the unpaid direct costs at issue in Claims 7 and 8. It has already recovered those direct costs by its overcharging of indirect costs over the years. Had the evidence established that MDC had not overcharged CRRA for indirect costs or if the seventy-five percent that MDC had been receiving pursuant to the Eagan panel's ruling was less than the actual indirect costs to which MDC was entitled, MDC would have

been able to recover the shortfall from the escrow. There is no shortfall. CRRA has already paid MDC $3,920,218 more than the actual costs, even after deducting the amounts of the additional direct costs identified in Claim 7 and 8. There is no basis for ordering CRRA to pay more to MDC, and the amount held in escrow is therefore the property of CRRA.

CRRA may not, however, recover the additional $3,920,218 that it overpaid MDC because the Agreement precludes an order that "result(s) in the District owing any monies to the Authority, regardless of fault." (Article VI (2)).

C. Claim for Cost of New Computer

MDC claimed in its expert witness' calculation of overpayments and underpayments by CRRA that an adjustment should be made in MDC's favor because CRRA had not been billed for a portion of the cost of MDC's new computer system. We reject MDC's claim that it is entitled to $3,322,539 from the escrow as a contribution by CRRA to MDC for the cost of its replacement of its computer system. MDC never identified this issue as a claim in its pleadings, either initially or when it filed an amended statement of its arbitration claims. That cost was never included in MDC's calculation of indirect costs for any of the years in which MDC incurred those costs, an indication that MDC has not, until this proceeding, viewed the item as an indirect cost to be charged to CRRA. The item is a capital expense of a type to which the Agreement does not require CRRA to contribute. The computer system would have cost the MDC the same amount if MDC were serving only its water and sewer customers, and the Mid-Connecticut Project thus did not impose an incremental cost on the MDC. We note that the parties handled another capital expense, the construction of a vehicle maintenance facility, through a separate contract, not as an item of indirect costs under the Agreement at issue in this proceeding.

CRRA has proven its counterclaim and is entitled to the sum now held in the escrow account and to the further prospective relief below, as specific performance of MDC's obligation to charge CRRA only its actual costs in connection with the Mid-Connecticut Project.

D. CRRA's Claim for Pre-Judgment Interest

Prejudgment interest is appropriate pursuant to Conn. Gen. Stat. Sec. 37-3a for the wrongful detention of money after it has become due. CRRA's claim against MDC is an unliquidated claim. CRRA's entitlement to credits and the amount of the credits was not determined until this ruling. No interest is due, however, the interest that has accrued in the escrow fund is the property of CRRA, as we have determined that none of those funds are due to MDC.

E. Prospective Relief

CRRA seeks as part of its remedy an order establishing a formula for the payment by CRRA to MDC of indirect costs for the duration of the Agreement. Both parties urged the panel, for the sake of simplicity in calculations going forward, to order that indirect costs be charged as a percentage of direct costs of services performed by the MDC on behalf of the CRRA under the Agreement for each fiscal year.

The expert witnesses presented by each party identified different percentages that they claimed accurately represented the actual indirect costs to the MDC of providing services to the CRRA under the Agreement over the past three years. MDC advocates that 17.5 %should be the rate applied to direct costs as the charge for indirect costs. CRRA claims that the rate applied should be 11%.

MDC has included in its calculation of indirect costs the expenses of some of its departments that provide no services or only the most minimal services to CRRA, notably, lobbying expenses (though CRRA is barred by statute from engaging in lobbying), and community affairs. Its expert included in his calculations some allocations based on the GOR approach that had resulted in overcharging in the past. The MDC's expert also inappropriately included in his calculations an allocation to CRRA of MDC's capital costs for upgrades of a new computer system.

The percentage advocated by CRRA's expert witness understates the indirect costs of MDC's provision of services to CRRA, since his own calculations show that the ratio of indirect costs to direct costs should increase as the CRRA reduces the functions entrusted to the MDC to perform.

After adjusting for the inclusions that are inappropriate or overstated, we conclude that the appropriate basis for the MDC to charge CRRA for indirect costs for the duration of the Agreement is 14.65% of the direct costs.

Conclusion

MDC has proven Claims 7 and 8 but it is entitled to no further remedy because it has already recovered the amounts due and more through overcharges collected from CRRA. MDC has not proven Claim 9.

CRRA has proven its counterclaim and the remedy shall be specific performance in the form of a credit for past overcharges that offset the amounts due under Claims 7 and 8. Its further remedy shall be that the funds in the escrow account shall be transferred to the CRRA.

Prospective relief is ordered as follows: Effective July 1, 2005, MDC shall charge CRRA for indirect costs by adding 14.65% to the direct costs incurred by MDC in performing its duties under the Mid-Connecticut Project Agreement. "Direct costs" shall be those categories of costs that have been denominated "direct costs" by the parties in the past.

Each party shall bear its own legal fees and costs. The arbitrators' fees and expenses of the arbitration hearing will be paid by the CRRA, as provided in Article VII of the Agreement.

Beverly J. Hodgson, Esq.

Jeffrey J. Tinley, Esq.

The third arbitrator, Mark S. Shipman, has stated his intention to file a dissent.

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Beverly J. Hodgson, Esq.

7/29/05

Jeffrey M. Finley, Esq.

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