



***NOPC 12
POTENTIAL CLAIM FOR
1% INCREASE IN STATEWIDE SALES & USE
TAX***

**PETER SIEGENTHALER, P.E.
RESIDENT ENGINEER**

PRESENTED BY: DON ROSS, P.E.

**DISTRICT 04 CONSTRUCTION
CALIFORNIA DEPARTMENT OF TRANSPORTATION**





IMPORTANT DEFINITIONS

- **“Fixed Price Contract” (per BusinessDictionary.com):**

Contract that provides for a price which normally is not subject to any adjustment unless certain provisions (such as contract change, economic pricing, or defective pricing) are included in the agreement. These contracts are negotiated usually where reasonably definite specifications are available, and costs can be estimated with reasonable accuracy. A fixed price contract places minimum administrative burden on the contracting parties, but subjects the contractor to the maximum risk arising from full responsibility for all cost escalations. (emphasis added)

- **“Work” (per Standard Specifications Section 1-1.48):**

All the work specified, indicated, shown or contemplated in the contract to construct the improvement, including all alterations, amendments or extensions thereto made by contract change order or other written orders of the Engineer. (emphasis added)

- **“Engineer” (per Standard Specifications Section 1-1.18):**

The Chief Engineer, Department of Transportation, acting either directly or through properly authorized agents, the agents acting within the scope of the particular duties delegated to them.



DEPARTMENT'S UNDERSTANDING OF ABF'S POSITION

STATE OF CALIFORNIA - DEPARTMENT OF TRANSPORTATION		FOR STATE USE ONLY	
SUPPLEMENTAL NOTICE OF POTENTIAL CLAIM		Received by _____	Date _____
CEM-6201B (NEW 9/2002)		(For resident engineer)	
TO Gary Pursell (resident engineer)	CONTRACT NUMBER 04-0120F4	DATE April 30, 2009	IDENTIFICATION NUMBER C12

This is a Supplemental Notice of Potential Claim for additional compensation submitted as required under the provisions of Section 9-1.04, "Notice of Potential Claim," of the Standard Specifications. The act of the engineer, or his/her failure to act, or the event, thing, occurrence, or other cause giving rise to the potential claim occurred on:

STATE OF CALIFORNIA - DEPARTMENT OF TRANSPORTATION		FOR STATE USE ONLY	
SUPPLEMENTAL NOTICE OF POTENTIAL CLAIM		Received by _____	Date _____
CEM-6201B (NEW 9/2002)		(For resident engineer)	
TO Gary Pursell (resident engineer)	CONTRACT NUMBER 04-0120F4	DATE April 30, 2009	IDENTIFICATION NUMBER 012

- o Section 4-1.03, Changes, Standard Specifications July 1999
- o Section 7-1.01, Laws to be Observed, Standard Specifications July 1999

The Contract requires the Contractor to observe and comply with the law, pay all taxes, and comply with Changes ordered by the Department. Public policy dictates that a Contractor is to be paid for Contract Changes resulting from State and Federal statutes and regulations enacted after the Contract has been awarded. For this reason, pursuant to Standard Specification 4-1.03 C, Changes in Character of Work, the issuance of a Change Order by the Department is required.

request for a Change Order and advised ABFJV that Caltrans has no legal authority to pay for the increased costs resulting from the sales and use tax increase because Contract No. 04-0123F4 was made without the authority of law.

At the time of bid (March 22, 2006), ABFJV carefully reviewed all applicable laws, rules, regulations, Federal, State or local government bodies, to be sure Contract Prices were established and agreed by ABFJV. The Contract requires the Contractor to observe and comply with the law, pay all taxes, and comply with Changes ordered by the Department. Public policy dictates that a Contractor is to be paid for Contract Changes resulting from State and Federal statutes and regulations enacted after the Contract has been awarded. For this reason, pursuant to Standard Specification 4-1.03 C, Changes in Character of Work, the issuance of a Change Order by the Department is required.

Subsequent to the award of the Contract, ABFJV requested a Change Order and advised ABFJV that Caltrans has no legal authority to pay for the increased costs resulting from the sales and use tax increase because Contract No. 04-0123F4 was made without the authority of law.

The Contract requires the Contractor to observe and comply with the law, pay all taxes, and comply with Changes ordered by the Department. Public policy dictates that a Contractor is to be paid for Contract Changes resulting from State and Federal statutes and regulations enacted after the Contract has been awarded. For this reason, pursuant to Standard Specification 4-1.03 C, Changes in Character of Work, the issuance of a Change Order by the Department is required.

The basis of this potential claim including all relevant contract provisions are:

- Applicable Contract provisions,
 - o Section 2-1.03, Examination of Plans, Specifications, Contract, and Site of Work, Standard Specifications July 1999
 - o Section 4-1.03 C, Changes in Character of Work, Standard Specifications July 1999

- Applicable Contract provisions,
 - o Section 2-1.03, Examination of Plans, Specifications, Contract, and Site of Work, Standard Specifications July 1999
 - o Section 4-1.03 C, Changes in Character of Work, Standard Specifications July 1999
 - o Section 4-1.03, Changes, Standard Specifications July 1999
 - o Section 7-1.01, Laws to be Observed, Standard Specifications July 1999
- Applicable California Civil Code provisions,
 - o Section 1635-1663
- Applicable California Public Contract Code provisions,
 - o Section 7100-7202
 - o Section 10220-10232
 - o Section 9201-9203

April 1, 2009 of

(attach sheets as _____)

analysis as required) _____
 comments are _____
 understood _____
 9-1.04 of _____
 Section 9- _____

Fluor

[Signature]

(representative)
 Fluor
 Director

OR

(representative)



ABF now agrees there is No Change in Character of the Work

3. There Was No Change in Character of the Work.

ABFJV believes that this issue is irrelevant to the matter currently before the DRB. **ABFJV is not alleging that the Character of the Work has changed.** ABFJV is claiming that we have been deprived of our rights to the benefits of the Contract because **the State breached its covenant of good faith and fair dealing** that exists in every contract pursuant to California law.

ABF Position Paper Pages 12 of 24

STATE OF CALIFORNIA - DEPARTMENT OF TRANSPORTATION		FOR STATE USE ONLY	
SUPPLEMENTAL NOTICE OF POTENTIAL CLAIM		Received by	Date
CEM-52018 (NEW 8/2002)		(for resident engineer)	
TO Gary Pursell (resident engineer)	CONTRACT NUMBER 04-0123F4	DATE April 30, 2009	IDENTIFICATION NUMBER 012

This is a Supplemental Notice of Potential Claim for additional compensation submitted as required under the provisions of Section 9-1.04, "Notice of Potential Claim," of the Standard Specifications. The act of the engineer, or his/her failure to act, or the event, thing, occurrence, or other cause giving rise to the potential claim occurred on:

DATE: April 10, 2009 by Caltrans response on RFPCO No. 83

The particular nature and circumstances of this potential claim are described in detail as follows:

In late February 2009, the State of California passed Assembly Bill 3 (AB3) into law. AB3 mandated a one percent (1%) increase to the State Sales and Use Tax for all purchases and payments made after April 1, 2009. In response to the State's mandate, American Bridge / Fluor Enterprises, Inc. A Joint Venture (ABFJV) sent the Department letter ABF-CAL-LTR-000854, dated March 12, 2009, requesting a Change Order to reimburse ABFJV the additional cost of the Tax increase for all Project purchases and payments paid after April 1, 2009.

In our Request for Change Order (RFPCO) letter ABF-CAL-LTR-000854, ABFJV requested that a Change Order be issued adjusting Contract compensation pursuant to the Contract Documents, including Standard Specifications, Article 2-1.03 Examination of Plans, Specifications, Contract, and Site of Work, Article 7-1.01, Laws to be Observed, and Article 4-1.03 C, Changes in Character of Work. Additionally, ABFJV relies upon the Contract provisions and the California State Codes identified in the "relevant Contract provisions" section below.

The Engineer's response in Department Letter No. 05.03.01-003827, dated April 10, 2009 rejected ABFJV's Request for a Change Order and advised ABFJV that Caltrans has no legal authority to pay for the increased costs resulting from the sales and use tax increase because Contract No. 04-0123F4 was made without the authority of law.

At the time of bid (March 22, 2006), ABFJV carefully examined the Plans and Specifications and the general and local conditions, including all existing and anticipated future taxes, imposed or contemplated at that time, by Federal, State or local government bodies, to be encountered in the performance of the Project. On the date the Contract Prices were established and agreed by ABFJV and the Department, April 18, 2006, the April 1, 2009 one (1) percent California's Sales and Use Tax rate increase did not exist, was not contemplated by the parties, and a reasonable and prudent contractor could not have foreseen the implementation of the future tax increase.

Subsequent to the award of the Contract, ABFJV to pay an additional one (1) percent increase is a Contract Change. Due to this Contract C

The Contract requires the Contractor to observe and comply with the law, pay all taxes, and comply with Changes ordered by the Department. Public policy dictates that a Contractor is to be paid for Contract Changes resulting from State and Federal statutes and regulations enacted after the Contract has been awarded. For this reason, pursuant to Standard Specification 4-1.03 C, Changes in Character of Work, the issuance of a Change Order by the Department is required.

The basis of this potential claim including all

- Applicable Contract provisions
 - o Section 2-1.03, Exam Standard Specifications
 - o Section 4-1.03 C, C 1999

ABF's claim has changed since the issuance of the NOPC:

Original Claim- tax increase is a change in the character of the work

New Claim- the Department breached the "covenant of good faith and fair dealing"

The Contract requires the Contractor to observe and comply with the law, pay all taxes, and comply with Changes ordered by the Department. Public policy dictates that a Contractor is to be paid for Contract Changes resulting from State and Federal statutes and regulations enacted after the Contract has been awarded. For this reason, pursuant to Standard Specification 4-1.03 C, Changes in Character of Work, the issuance of a Change Order by the Department is required.



CALTRANS POSITION

- Dispute arose from events external to the contract
- Taxable events occurred under separate contracts between the Contractor and its suppliers.
- Increased sales tax resulted from a sovereign act which was public and general making it subject to the Sovereign Acts Doctrine.



CALTRANS POSITION (CONTINUED)

- No Breach of contract
- No Ordered Change
- No escalation clauses in the contract. Changes in Contractor's costs do not cause changes in fixed bid prices
- No effect on the work
- No effect on means & methods



CALTRANS POSITION (CONTINUED)

- None of the allowable contractual adjustments in compensation apply to the increase in tax issue:
 - No increase or decrease in quantities
 - No differing site conditions
 - No right of way delays
 - No change in character of the work
 - No extra work



CALTRANS POSITION (CONTINUED)

APPLICABLE SPECIFICATIONS

Standard Specifications:

- 4-1.03, "Changes"
 - Allows the Department to make changes to the plans and specifications
 - Compensates the Contractor for changes ordered by the Department necessary to complete the work
 - No contractual requirements have changed
 - If the sales tax rate were to decrease, the Department cannot write a change order to take money back from the Contractor



No "ORDERED CHANGE" WAS ISSUED BY THE DEPARTMENT

STATE OF CALIFORNIA - DEPARTMENT OF TRANSPORTATION		FOR STATE USE ONLY	
SUPPLEMENTAL NOTICE OF POTENTIAL CLAIM CEM-2019 (NEW 9/2002)		Received by _____	Date _____
TO: Gary Puntal (contract engineer)	CONTRACT NUMBER 04-023F4	DATE April 30, 2009	IDENTIFICATION NUMBER 012
<p><i>This is a Supplemental Notice of Potential Claim. An additional compensation submitted as required under the provisions of Section 9-2.04, "Notice of Potential Claim," of the Standard Specifications. The act of the engineer, or his/her failure to act, or the event, thing, occurrence, or other cause giving rise to the potential claim occurred on:</i></p> <p style="text-align: center;"><i>(S/N)</i> April 10, 2009 by Caltrans response or RFCD No. 42</p> <p>The particular nature and circumstances of the potential claim are described in detail as follows:</p> <p>In late February 2009, the State of California passed Assembly Bill 3 (AB3) into law. AB3 mandated a one percent (1%) increase to the State Sales and Use Tax for all purchases and payments made after April 1, 2009. In response to the State's mandate, American Bridge / Fluor Enterprises, Inc. A Joint Venture (ABFJV) sent the Department letter ABF-CAL-LTR-000854, dated March 12, 2009, requesting a Change Order to reimburse ABFJV the additional cost of the Tax increase for all Project purchases and payments paid after April 1, 2009.</p> <p>In our Request for Change Order (RFCD) letter ABF-CAL-LTR-000854, ABFJV requested that a Change Order be issued adjusting Contract compensation pursuant to the Contract Documents, including Standard Specifications, Article 2-1.03 Examination of Plans, Specifications, Contract, and Site of Work, Article 7-1.01, Laws to be Observed, and Article 4-1.03 C, Changes in Character of Work. Additionally, ABFJV relies upon the Contract provisions and the California State Codes identified in the "relevant Contract provisions" section below.</p> <p>The Engineer's response in Department Letter No. 05.03.01-00327, dated April 10, 2009 rejected ABFJV's Request for a Change Order and advised ABFJV that Caltrans has no legal authority to pay for the increased costs resulting from the sales and use tax increase because Contract No. 04-0123F4 was made without the authority of law.</p> <p>At the time of bid (March 22, 2006), ABFJV carefully examined the Plans and Specifications and the general and local conditions, including all existing and anticipated future taxes, imposed or contemplated at that time, by Federal, State or local government bodies, to be encountered in the performance of the Project. On the date the Contract Prices were established and agreed by ABFJV and the Department, April 18, 2006, the April 1, 2009 one (1) percent California's Sales and Use Tax rate increase did not exist, was not contemplated by the parties, and a reasonable and prudent contractor could not have foreseen the implementation of the future tax increase.</p> <p>Subsequent to the award of the Contract, ABFJV received a written "order" issued by the State directing ABFJV to pay an additional one (1) percent increase in the California State Sales and Use Tax rate. This written "order" is a Contract Change. Due to this Contract Change, the actual unit cost of the Contract Items has increased.</p> <p>The Contract requires the Contractor to observe and comply with the law, pay all taxes, and comply with Changes ordered by the Department. Public policy dictates that a Contractor is to be paid for Contract Changes resulting from State and Federal statutes and regulations enacted after the Contract has been awarded. For this reason, pursuant to Standard Specification 4-1.03 C, Changes in Character of Work, the issuance of a Change Order by the Department is required.</p>			
<small>(Other additional claims as noted)</small>			
<p>The basis of this potential claim including all relevant contract provisions are listed as follows:</p> <ul style="list-style-type: none"> • Applicable Contract provisions, <ul style="list-style-type: none"> o Sections 2-1.00, Examination of Plans, Specifications, Contract, and Site of Work, Standard Specifications July 1999 o Section 4-1.03 C, Changes in Character of Work, Standard Specifications July 1999 			

Caltrans Appendix B-4



Special Notice

Sales and Use Tax Rate Increases on April 1, 2009

Effective April 1, 2009, the state sales and use tax rate increases by 1%. In addition, if you are in a city or county that has a voter approved local district tax rate increase effective on April 1, 2009, your overall tax rate increase will be higher. Please see the Special Notice included in this mailing. The combined statewide and district tax rates that apply as of April 1, 2009, are listed on the reverse side of this notice.

The 1% tax rate increase will expire on either July 1, 2011, or July 1, 2012, depending upon whether the voters approve the proposed Budget Stabilization constitutional amendment in a statewide election to be held on May 19, 2009.

What if I collect tax at the lower tax rate for sales made after April 1, 2009?
If you incorrectly collect sales tax reimbursement or use tax at the lower tax rate after April 1, 2009, you will still owe the 1% difference.

What if a customer purchases merchandise before April 1, 2009, but returns it after that date, what tax rate should I use to refund the tax payment?
You should refund tax based on the rate in effect at the time of the sale (i.e., the amount you collected from the customer).

Taxpayer Information Section
For a current listing of California sales and use tax rates by county and city, please visit our website at www.boe.ca.gov/cgi-bin/rates.cgi. If you have any questions regarding this notice, please call our toll-free number to speak with a Customer Service Representative. Representatives are available weekdays from 8:00 a.m. to 5:00 p.m. Pacific time, except state holidays. Please call:

800-400-7115 TDD/TTY: 800-735-2929

In addition to English, assistance is also available in other languages.

BOE WEBSITE AND BOARD MEMBER CONTACT INFORMATION
www.boe.ca.gov

TAXPAYERS' RIGHTS ADVOCATE
888-724-9708

TAXPAYER INFORMATION SECTION
800-400-7115
TDD/TTY:
800-735-2929

Caltrans Appendix B-1

Subsequent to the award of the Contract, ABFJV received a written "order" issued by the State directing ABFJV to pay an additional one (1) percent increase in the California State Sales and Use Tax rate. This written "order" is a Contract Change. Due to this Contract Change, the actual unit cost of the Contract Items has increased.

- ABF's position is based on a "Special Notice" from the BOE
- This is not an Ordered Change made by the Department



CALTRANS POSITION (CONTINUED)

APPLICABLE SPECIFICATIONS

Standard Specifications: (Continued)

- 7-1.01, "Laws to be Observed"
 - Requires the Contractor to comply with the law.
 - The Contractor is required to protect and indemnify the State from violation of any law.
 - The Contractor is required to report to the Engineer any discrepancy between the law and the specifications.



CALTRANS POSITION (CONTINUED)

APPLICABLE SPECIFICATIONS

Standard Specifications: (Continued)

- 7-1.03, "Payment of Taxes"
 - Contract prices include full compensation for all taxes which the contractor is required to pay.
 - No document designed to exempt the Contractor from payment of any tax (including specifically a tax on materials) will be furnished to the Contractor by the Department

- 9-1.02, "Scope of Payment"
 - The Contractor shall accept the compensation provided in the contract as full payment for furnishing all labor, materials, tools, equipment and incidentals necessary to the completed work and for performing all work contemplated and embraced under the contract.



CALTRANS POSITION (CONTINUED)

APPLICABLE SPECIFICATIONS

- 9-1.02, "Scope of Payment" (Cont.)
 - Contractor is responsible for risks of every description connected with the prosecution of the work
 - Many contractual risks exist – Only some are allowed adjustments in compensation under this contract
 - No specific exemption for risk of changes in the State's sales tax laws
 - An increase in the rate of an existing tax is one of the usual hazards of business enterprise.



STATE OF CALIFORNIA
DEPARTMENT OF TRANSPORTATION

**EXECUTION
OF
CONTRACT**

FOR CONSTRUCTION ON
STATE HIGHWAY
IN
SAN FRANCISCO COUNTY IN SAN FRANCISCO FROM 0.6
KM TO 1.3 KM EAST OF THE VERRA BUENA TUNNEL
EAST PORTAL

DISTRICT 04 ROUTE 80

For use in Connection with Standard Specifications Dated July 99, Standard
Plans Dated July 99, and Labor Surcharge and Equipment Rental Rates.

Contract No. 04-0120F4

04-SF-80-13.2/13.9

NO FED AID

Please return Contracts Within
10 Days to:

Department of Transportation
Attn: Office Engineer MS 43
1727 30th Street
Sacramento CA 95816

Bids Open: March 22, 2006

BIDDERS PLEASE NOTE

Bid Summaries available at:

<http://www.dot.ca.gov/hq/esc/oe/>

11.05

ARTICLE V. OF THE EXECUTION OF THE CONTRACT

- Reinforces Standard Specification 9-1.02
- The Contract prices include “full compensation for furnishing all materials”

ARTICLE V.-- And the said Contractor agrees to receive and accept the following price or prices as full compensation for furnishing all materials and for doing all the work contemplated and embraced in this agreement; also for all loss or damage, arising out of the nature of the work aforesaid, or from the action of the elements, or from any unforeseen difficulties or obstructions which may arise or be encountered in the prosecution of the work until its acceptance by the Department of Transportation, and for all risks of every description connected with the work; also for all expenses incurred by or in consequence of the suspension or discontinuance of work and for well and faithfully completing the work, and the whole thereof, in the manner and according to the plans and special provisions, and the requirements of the Engineer under them, to wit:



SALES TAX HISTORY 1933 TO 2009

- Increased 9 times
- Decreased 6 times

CA.GOV California State Board of Equalization

Home Board Members eServices Taxes & Fees Forms & Publications Your Rights Languages Contact Us

Overview | Environmental Fees | Excise Taxes | Fuel Taxes | Property Tax | Sales & Use Tax |

History of Sales & Use Tax Rates
(Excludes District Taxes)

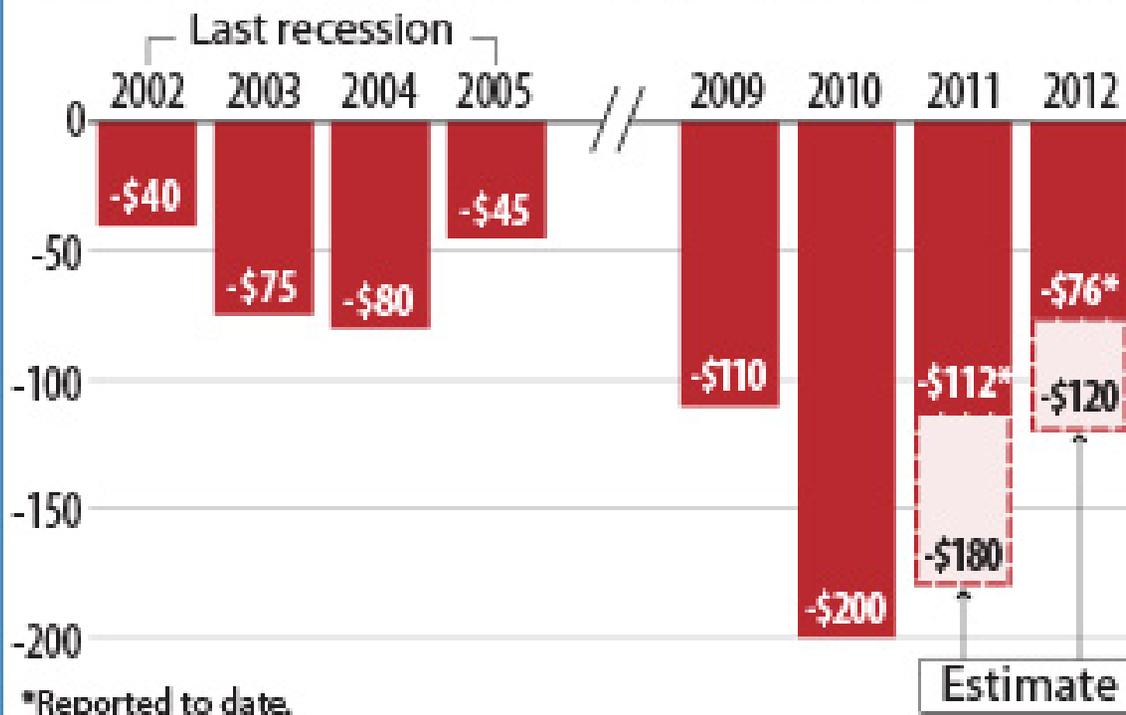
Effective Date	End Date	State Rate
4/01/09	Current	7.25%*
7/01/04	3/31/09	6.25%*
1/01/02	6/30/04	6.00%
1/01/01	12/31/01	5.75%
7/15/91	12/31/00	6.00%
1/01/91	7/14/91	4.75%
12/01/89	12/31/90	5.00%
4/01/74	11/30/89	4.75%
10/01/73	3/31/74	3.75%
7/01/73	9/30/73	4.75%
7/01/72	6/30/73	3.75%
8/01/67	6/30/72	4.00%
1/01/62	7/31/67	3.00%
7/01/49	12/31/61	3.00%
7/01/43	6/30/49	2.50%
7/01/35	6/30/43	3.00%
8/01/33**	6/30/35**	2.50%



AB 3 ENACTED AS A RESULT OF THE ECONOMIC DOWNTURN AND CALIFORNIA'S BUDGET CRISIS

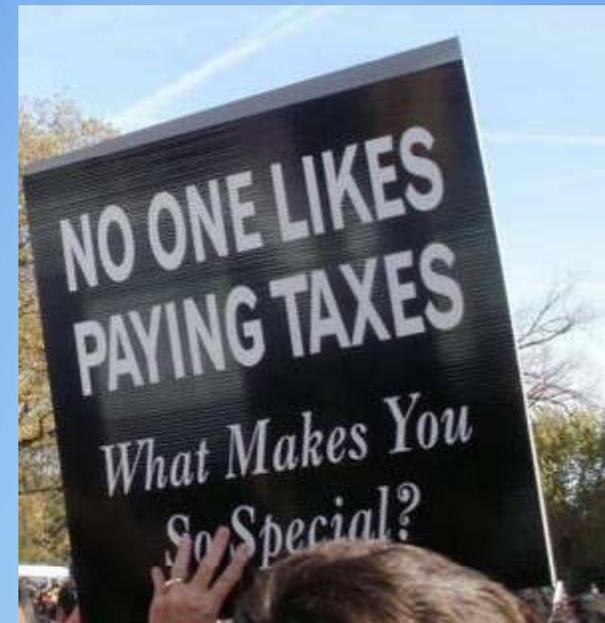
Figure 2:
How Bad Will It Get?

Total state budget shortfall in each fiscal year, in billions



Source: CBPP survey.

cbpp.org





ASSEMBLY BILL 3 BACKGROUND

- Assembly Bill 3 (Evans) – Passed into Law Feb 20, 2009:
 - Was necessary to implement special session budget agreement reached in January 2009.
 - Legislature increased sales tax rate for all California consumers effective April 1, 2009.
 - No CCO language or exemption for fixed price contracts made it into the bill though it was requested by Industry.



AB 1523

EXEMPTION FOR FIXED PRICE CONTRACTS

- Assembly Bill 1523 (Calderon) Feb 27, 2009:
 - Prompted by a request by Industry organizations to exempt fixed price contracts.
 - Proposed to exempt fixed price contracts from the 1% increase in sales and use tax passed in AB 3
 - Indication that Industry recognizes need for exemption.
 - Died in Committee Feb 2, 2010



AB 2060

EXEMPTION FOR FIXED PRICE CONTRACTS

- Assembly Bill 2060 (Calderon) – Feb 17, 2010
 - AB 2060 proposed to exempt certain sales related to fixed price contracts from **future sales tax rate increases**
 - Arguments used for requesting legislation conflict with arguments presented here.
 - *“This bill is co-sponsored by several contractors associations, for the purpose of protecting contractors with fixed price contracts from bearing the cost of a sales and use tax rate increase that cannot be passed on to their customers.” (emphasis added)*
 - *“Due to the nature of a fixed price contract, the contractor may not pass the increase on to the customer, and must bear the full out-of-pocket cost of the rate increase. This became an issue last year with respect to fixed price contracts that CalTrans had awarded for the Bay Bridge.” (emphasis added)*
 - Vetoed by Governor on Sept 30, 2010



NO LEGAL REQUIREMENT OR AUTHORITY TO REIMBURSE THE CONTRACTOR

- Western Contracting Corp. v. State Board of Equalization; and John McShain v. District of Columbia
 - Contractor is not entitled to additional compensation due to tax increase.
 - Applies to ALL costs not specifically exempted.
 - Western and McShain Courts found support in U.S. Supreme Court and Federal Court rulings.



APPLICABLE LAW

WESTERN CONTRACTING V BOE

39 Cal.App.3d 341
39 Cal.App.3d 341, 114 Cal.Rptr. 227
(Cite as: 39 Cal.App.3d 341, 114 Cal.Rptr. 227)

Page 5

against the Board was that Western 'take nothing.'

FN3. Continental Leasing Corporation, a lessor of equipment to Western, brought a third action (No. 986 787), seeking refund of sales tax paid by it. This action, which was consolidated for trial with Western's two lawsuits, does not require further discussion inasmuch as Continental's appeal has been dismissed.

Western appealed from those portions of the declaratory judgment adverse to it and from the judgment against it on the refund claim. The Department filed an appeal from the portion of the judgment denying its defense based upon the release.

None of the appealing parties questions the findings of fact made by the trial court. The issues, therefore, relate to the propriety of the court's conclusions based thereon.

Issues

There are three issues which require determination on this appeal. They are:

1. Did [section 6376](#), properly construed, provide an exemption from the increase in sales and use tax with respect to the construction equipment and supplies utilized in the performance of Western's contract?
2. Does the contract between Western and the Department provide for additional compensation to Western equal to the increased tax burden borne by it?
3. Is there an impairment of the obligation of Western's contract if the exemption is not applicable and it receives no additional compensation?

As will hereafter appear, other issues raised by the parties do not require resolution in view of the decision reached with respect to the above issues.

Interpretation of [Section 6376](#)

[Section 6376](#) has never been interpreted in any decided case brought to the attention of this court. The evidence of its legislative history is limited, consisting solely of a statement by Senator Coombs in the course of proceedings before the State Board of Equalization on November 8, 1967, to the effect that as originally drafted, the words 'tangible personal property' appeared where the words 'material and fixtures' appear in the first paragraph of the section as enacted. The change was made 'during the course of the discussions of the Conference Committee' at the suggestions of a member of the staff of the Board. The Board argues that this history supports its interpretation of [section 6376](#) because its staff member in recommending the use of the words 'material and fixtures' had clearly in mind the meaning ascribed to them in Ruling 11. Assuming this to be a fact, it is of little help in the interpretation of the statute unless such *347 understanding was communicated to the members of the Legislature, and there is no evidence that it was.

A second argument advanced by the Board also lacks merit. The Board contends that the use and consumption of the construction equipment and supplies was not 'obligated' under the terms of the contract with the Department because the contract does not 'describe the types of tools or equipment which must be used.' However, section 6(g) of the contract generally requires the contractor 'to provide and use on the work only such construction equipment and plant as are capable of producing the quality and quantity of work and materials required by the contract within the time or times specified.' Consequently, though there may have been no specifications of the type described in section 6(h) of said contract 'providing that construction**232 equipment of a particular size or type is to be used,' it is obvious that large amounts of massive construction equipment consuming vast quantities of fuel and other supplies were necessarily involved in the performance of the contract.

[1] The more persuasive argument urged by the Board is based upon the fact that Ruling 11 had been in effect and widely applied in the administration of the Sales and Use Tax Law for over 20 years at the time [section 6376](#) was enacted. The propriety of the classifications of tangible personal property set forth in Ruling 11, including 'materials' and 'fixtures,' had

Issues

There are three issues which require determination on this appeal. They are:

1. Did [section 6376](#), properly construed, provide an exemption from the increase in sales and use tax with respect to the construction equipment and supplies utilized in the performance of Western's contract?
2. Does the contract between Western and the Department provide for additional compensation to Western equal to the increased tax burden borne by it?
3. Is there an impairment of the obligation of Western's contract if the exemption is not applicable and it receives no additional compensation?



APPLICABLE LAW

WESTERN CONTRACTING V BOE

39 Cal.App.3d 341
39 Cal.App.3d 341, 114 Cal.Rptr. 227
(Cite as: 39 Cal.App.3d 341, 114 Cal.Rptr. 227)

Page 2

Statute which exempted from increase in sales and use taxes "materials" and "fixtures" in the sale, storage, use or other consumption of the material and fixtures which were obligated pursuant to an engineering construction project contract entered into for a fixed price prior to August 1, 1967, did not provide an exemption from the increase in sales and use taxes with respect to construction equipment and supplies utilized in performance of contract with the Department of Water Resources to build dam. [West's Ann.Rev. & Tax.Code, § 6376.](#)

[\[3\]](#) Taxation 371 ↔ 3638

[371](#) Taxation
[371IX](#) Sales, Use, Service, and Gross Receipts Taxes

[371IX\(C\)](#) Transactions Taxable in General
[371k3637](#) Subjects and Exemptions in General
[371k3638](#) k. In General. [Most Cited](#)

[Cases](#)
(Formerly 371k1220)

Taxation 371 ↔ 3639

[371](#) Taxation
[371IX](#) Sales, Use, Service, and Gross Receipts Taxes

[371IX\(C\)](#) Transactions Taxable in General
[371k3637](#) Subjects and Exemptions in General
[371k3639](#) k. Use Tax. [Most Cited](#)

[Cases](#)
(Formerly 371k1220)

Statute which exempted from increase in sales and use taxes "materials" and "supplies" if such materials and supplies were obligated pursuant to an engineering construction project under contract entered into for fixed price prior to August 1, 1967, was a tax exemption provision which was to be narrowly construed. [West's Ann.Rev. & Tax.Code, § 6376.](#)

[\[4\]](#) States 360 ↔ 104

[360](#) States
[360III](#) Property, Contracts, and Liabilities
[360k104](#) k. Construction and Operation of

Contracts. [Most Cited Cases](#)

Where contract with Department of Water Resources to build dam provided that the contract price included full compensation for all taxes which the contractor is required to pay, whether imposed by federal, state, or local government, contract further provided that the contract price of the work would include full compensation for all costs incurred and the provisions of the contract relating to "changes in the contract" pertained only to those which affected the amount or quality of the work, contractor was not entitled to additional compensation on account of increased tax burden which resulted from increase in state sales and use taxes. [West's Ann.Rev. & Tax.Code, § 6376.](#)

[\[5\]](#) States 360 ↔ 104

[360](#) States
[360III](#) Property, Contracts, and Liabilities
[360k104](#) k. Construction and Operation of Contracts. [Most Cited Cases](#)

Provision of contract with Department of Water Resources for dam construction which authorized engineer to order "such changes in the contract as are required for the proper completion of the work" and which permitted payment of additional compensation whenever changes cannot be fairly and reasonably paid for at contract prices did not permit contractor to recover additional compensation on account of increased sales and use tax burden where the change in the sales tax rate had nothing whatever to do with "proper completion of the work." [West's Ann.Rev. & Tax.Code, § 6376.](#)

[\[6\]](#) Constitutional Law 92 ↔ 2718

[92](#) Constitutional Law
[92XXII](#) Obligation of Contract
[92XXII\(B\)](#) Contracts with Governmental Entities

[92XXII\(B\)2](#) Particular Issues and Applications
[92k2717](#) Taxation
[92k2718](#) k. In General. [Most Cited](#)

[Cases](#)
(Formerly 92k137)

Where contractor received from the Department of Water Resources the full fixed price specified in the contract for construction of dam, increase in the sales

Contracts. [Most Cited Cases](#)

Where contract with Department of Water Resources to build dam provided that the contract price included full compensation for all taxes which the contractor is required to pay, whether imposed by federal, state, or local government, contract further provided that the contract price of the work would include full compensation for all costs incurred and the provisions of the contract relating to "changes in the contract" pertained only to those which affected the amount or quality of the work, contractor was not entitled to additional compensation on account of increased tax burden which resulted from increase in state sales and use taxes. [West's Ann.Rev. & Tax.Code, § 6376.](#)

Caltrans Appendix C-9



WESTERN CONTRACTING V BOE

SPECS SIMILAR TO CT SPECS

7-1.03 PAYMENT OF TAXES

The contract prices paid for the work shall include full compensation for all taxes which the Contractor is required to pay, whether imposed by Federal, State or local government, including, without being limited to, Federal excise tax. No tax exemption certificate nor any document designed to exempt the Contractor from payment of any tax will be furnished to the Contractor by the Department, as to any tax on labor, services, materials, transportation, or any other items furnished pursuant to the contract.

Caltrans Appendix A-4

[4] The contract provides generally that 'The contract price . . . of the work shall include full compensation for all costs incurred.'(s 9(b).) More specifically, with respect to the subject of taxes, section 4(h) states:

'Except as otherwise provided in the Special Provisions, the contract prices shall include full compensation for all taxes which the Contractor is required to pay, whether imposed by federal, state, or local government, and no tax exemption certificate or any other document designed to exempt the Contractor from payment of tax will be furnished to the Contractor by the Department.'

contract is correct. In view of this determination, it is necessary to pass upon the Department's contentions raised by its appeal that a release signed by Western covering all claims and demands arising under and in virtue of the contract, included its claim for additional compensation on account of the enhanced sales and use tax rate. The court, therefore, expresses no opinion on this question. ^{FN4}

In view of the fact that this question has become moot and this court has not approved the trial court's decision in this respect, the judgment will be modified to eliminate it.

Claimed Caltrans Appendix C-9



WESTERN CONTRACTING V BOE

SPECS SIMILAR TO CT SPECS

39 Cal.App.3d 341
39 Cal.App.3d 341, 114 Cal.Rptr. 227
(Cite as: 39 Cal.App.3d 341, 114 Cal.Rptr. 227)

Page 7

this interpretation being placed upon it, section 36 of Statutes of 1972 was amended to clarify its applica-

tion of the work.'(s 7(b).) Such changes *350 may result in additional compensation whenever they can-

To support its claim for extra compensation, Western relies upon the provisions of the contract relating to 'changes in the contract.' Section 7 of the contract deals with this subject matter. An examination of its provisions in this respect, however, indicates clearly that the changes for which an adjustment in compensation may be authorized are only those which affect the amount or quality of the work.

of the increased tax burden. W

[4] The contract provides generally that 'The contract price . . . of the work shall include full compensation for all costs incurred.'(s 9(b) More specifically, with respect to the subject matter at issue, section 4(h) states:

'Except as otherwise provided in the Special Provisions, the contract prices shall include full compensation for all taxes which the Contractor is required to pay, whether imposed by federal, state, or local government, and no tax exemption certificate or any other document designed to exempt the Contractor from payment of tax will be furnished to the Contractor by the Department.'

To support its claim for extra compensation, Western relies upon the provisions of the contract relating to 'changes in the contract.' Section 7 of the contract deals with this subject matter. An examination of its provisions in this respect, however, indicates clearly that the changes for which an adjustment in compensation may be authorized are only those which affect the amount or quality of the work.

[5] The engineer is authorized to order 'such changes in the contract as are required for the proper comple-

The trial court's interpretation of the construction contract is therefore correct. In view of this determination, it is not necessary to pass upon the Department's contention raised by its appeal that a release signed by Western, covering all claims and demands arising under and by virtue of the contract, included its claim for additional compensation on account of the enhanced sales and use tax rate. The court, therefore, expresses no opinion on this question. FN4

FN4. In view of the fact that this question has become moot and this court has not approved the trial court's decision in this respect, the judgment will be modified to eliminate it.

Claimed Impairment of Contract

Western contends that the imposition of the additional tax burden upon it in combination with the denial of its claim for further compensation unconstitutionally impairs the State's obligation under its contract. The constitutional provisions relied on are: (a) Article 1, section 10 of the Constitution of the United States, (b) the due process clause of the Fourteenth Amendment, and (c) Article 1, section 16 of the Constitution of California.

Caltrans Standard Specifications Section 4-1.03

- Only changes required for the proper completion or construction of the whole work contemplated

this interpretation being placed upon it, section 36 of Statutes of 1972 was amended to clarify its applicability to both sales and use taxes but without in any respect modifying the description of personal property exempted. (Stats.1973, ch. 208, s 61.)

[3] Both the language and the legislative history, therefore, strongly support the interpretation urged by the Board. In addition, [section 6376](#) is a tax exemption provision. As such, it is to be narrowly construed. ([Santa Fe Transp. v. State Board of Equal.](#), 51 Cal.2d 531, 539, 334 P.2d 907; [Good Humor Co. v. State Board of Equal.](#), 152 Cal.App.2d 873, 879, 313 P.2d 640.)The trial court's interpretation of it was therefore correct.

Additional Compensation Under the Contract

The trial court construed the construction contract as not providing for additional compensation on account of the increased tax burden. We agree.

[4] The contract provides generally that "The contract price . . . of the work shall include full compensation for all costs incurred.'(s 9(b).) More specifically, with respect to the subject of taxes, section 4(h) states:

'Except as otherwise provided in the Special Provisions, the contract prices shall include full compensation for all taxes which the Contractor is required to pay, whether imposed by federal, state, or local government, and no tax exemption certificate or any other document designed to exempt the Contractor from payment of tax will be furnished to the Contractor by the Department.'

To support its claim for extra compensation, Western relies upon the provisions of the contract relating to 'changes in the contract.' Section 7 of the contract deals with this subject matter. An examination of its provisions in this respect, however, indicates clearly that the changes for which an adjustment in compensation may be authorized are only those which affect the amount or quality of the work.

[5] The engineer is authorized to order 'such changes in the contract as are required for the proper comple-

tion of the work.'(s 7(b).) Such changes *350 may result in additional compensation whenever they cannot 'be fairly and reasonably paid for at contract prices.'(s 7(e).) A change in the tax rate does not qualify under this provision because it has nothing whatever to do with 'proper completion of the work.'

Provision is also made for notification of 'changed conditions' which, if they 'materially increase or decrease the costs of any portion of the work,' may be the subject of an adjustment to compensation. (s 7(h).) However, the kinds of changed **234 conditions provided for are (1) 'Subsurface or latent physical conditions at the site of the work differing materially from those represented in this contract,' and (2) 'Unknown physical conditions at the site of the work of an unusual nature differing materially from those ordinarily encountered.'A change of the tax rate does not fall into either of these categories.

The trial court's interpretation of the construction contract is therefore correct. In view of this determination, it is not necessary to pass upon the Department's contention raised by its appeal that a release signed by Western, covering all claims and demands arising under and by virtue of the contract, included its claim for additional compensation on account of the enhanced sales and use tax rate. The court, therefore, expresses no opinion on this question. ^{FN4}

^{FN4}. In view of the fact that this question has become moot and this court has not approved the trial court's decision in this respect, the judgment will be modified to eliminate it.

W
tic
de
tul
tra
At
St
Ar
sti

APPLICABLE LAW WESTERN CONTRACTING

[5] The engineer is authorized to order 'such changes in the contract as are required for the proper completion of the work.'(s 7(b).) Such changes *350 may result in additional compensation whenever they cannot 'be fairly and reasonably paid for at contract prices.'(s 7(e).) A change in the tax rate does not qualify under this provision because it has nothing whatever to do with 'proper completion of the work.'

Caltrans Standard Specifications Section 4-1.03

- Specifies kinds of changed conditions that warrant adjustment in compensation.
- A change of the tax rate does not fall into these specified conditions.



CALTRANS POSITION (CONTINUED)

APPLICABLE LAW – WESTERN CONTRACTING

39 Cal.App.3d 341
39 Cal.App.3d 341, 114 Cal.Rptr. 227
(Cite as: 39 Cal.App.3d 341, 114 Cal.Rptr. 227)

Page 9

tional prohibition with the necessary residuum of state power has had progressive recognition in the decisions of this Court.' 290 U.S., at 434-435, 54 S.Ct. at 238-239. Moreover, the 'economic interests of the State may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts.' *Id.*, at 437 (54 S.Ct. at 239). The State has the 'sovereign right . . . to protect the . . . general welfare of the people Once we are in this domain of the reserve power of a State we must respect the 'wide discretion on the part of the legislature in determining what is and what is not necessary'. *East New York Savings Bank v. Hahn*, 326 U.S. 230, 232-233, 66 S.Ct. 69, 71, 90 L.Ed. 34. As Mr. Justice Johnson said in *Ogden v. Saunders*, '(i)t is the motive, the policy, the object, that must characterize the legislative act, to affect it with the imputation of violating the obligation of contracts.' 12 *Wheat*, 213, 291, 6 L.Ed. 606.

'Of course, the power of a State to modify or affect the obligation of contract is not without limit. (W)hatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. The reserved power cannot be construed so as to destroy the limitation, Nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other. This principle precludes a construction which would permit the State to adopt As its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them.' (Emphasis added.) (379 U.S. at pp. 508-509, 85 S.Ct. at pp. 583.)

**236 [8] Under the holding of the court in *El Paso*, the application of the tax *353 increase to Western was clearly valid. There is absolutely nothing in the record to suggest that the motive of the Legislature was other than that of raising general revenue to meet public need. Contractors under public contracts were not singled out for less favorable treatment than that accorded other contracting parties. They were in fact given a dispensation along with all others who had fixed-price construction contracts. Giving, as we must, 'respect (to) the 'wide discretion on the part of the legislature in determining what is and what is not necessary' this court can only conclude that the policy of this legislation was legitimate and it is there-

fore valid.

Under circumstances virtually identical to those presented by this appeal, the Court of Appeals in *John McShain, Inc. v. District of Columbia*, 92 U.S.App.D.C. 358, 205 F.2d 882, upheld the application of the District's sales and use tax to a contractor with an antecedent fixed-price construction contract with the District. In that case the court did not have the benefit of the subsequent opinion in *El Paso v. Simmons*. Its reasoning, however, fits exactly the criteria stated by the Supreme Court. In upholding the validity of the tax, the court said:

' . . . Nor does the statute impair a contractual obligation. The imposition of a new tax, or an increase in the rate of an old one, is one of the usual hazards of business enterprise: seldom, if ever, does such an event impair the obligation of a pre-existing contract. See *Wiseman v. Gillioz*, 1936, 192 Ark. 950, 96 S.W.2d 459. The Contract Clause, of course, is a limitation on state rather than federal action. Nevertheless, a measure of protection against contract impairment by the federal government is given by the Fifth Amendment. *Perry v. United States*, 1935, 294 U.S. 330, 55 S.Ct. 432, 79 L.Ed. 912; *Lynch v. United States*, 1934, 292 U.S. 571, 54 S.Ct. 840, 78 L.Ed. 1434. But Congress was not here seeking to repudiate or render profitless petitioner's contracts with the United States and the District of Columbia. Rather, it sought additional tax revenues for the District, through a general statute affecting petitioner no more severely than others who made purchases and sales. Cf. *O'Malley v. Woodrough*, 1939, 307 U.S. 277, 59 S.Ct. 838, 83 L.Ed. 1289. There was no deprivation of petitioner's property without due process of law. . . . ' (205 F.2d at pp. 883-884.)

It is unnecessary to discuss the public pension cases relied upon by Western. They involve legislation directly modifying the obligations of public contracts rather than incidental burdens created by general legislation.^{FN6}

^{FN6} The same is true of the opinion of the First Circuit in *People of Porto Rico v. Havemeyer*, 60 F.2d 10, also cited by appellant.

Under circumstances virtually identical to those presented by this appeal, the Court of Appeals in *John McShain, Inc. v. District of Columbia*, 92 U.S.App.D.C. 358, 205 F.2d 882, upheld the application of the District's sales and use tax to a contractor with an antecedent fixed-price construction contract with the District. In that case the court did not have the benefit of the subsequent opinion in *El Paso v. Simmons*. Its reasoning, however, fits exactly the criteria stated by the Supreme Court. In upholding the validity of the tax, the court said:

' . . . Nor does the statute impair a contractual obligation. The imposition of a new tax, or an increase in the rate of an old one, is one of the usual hazards of business enterprise: seldom, if ever, does such an event impair the obligation of a pre-existing contract. See *Wiseman v. Gillioz*, 1936, 192 Ark. 950, 96 S.W.2d 459. The Contract Clause, of course, is a



CALTRANS POSITION (CONTINUED)

APPLICABLE LAW

JOHN McSHAIN V DISTRICT OF COLUMBIA

In paragraph 4 of the John McShain appellate court findings:

...And it is the purchase (or use) itself, not the signing of construction contracts ultimately necessitating the purchase, which is the taxable event. It is irrelevant in the present connection that the construction contracts were made prior to the date of the Act: a statute is not necessarily objectionable as being retroactive if antecedent facts affect its operation...

...Nor does the statute impair a contractual obligation. The imposition of a new tax, or an increase in the rate of an old one, is one of the usual hazards of business enterprise...

...Congress was not here seeking to repudiate or render profitless petitioner's contracts with the United States and the District of Columbia. Rather, it sought additional tax revenues for the District, through a general statute affecting petitioner no more severely than others who made purchases and sales...



SOVEREIGN ACTS DOCTRINE

39 Cal.App.3d 341
39 Cal.App.3d 341, 114 Cal.Rptr. 227
(Cite as: 39 Cal.App.3d 341, 114 Cal.Rptr. 227)

Page 8

[6][7] Inasmuch as Western received the full fixed-price specified in its contract for the work, this contention amounts to the assertion that any increase in the tax burden incident to performance constituted an impairment of the obligation of its contract. Western concedes that an identical contract between it and a private owner would not be unconstitutionally impaired by any such increase. That concession is clearly required by well established case authority. In *National Ice, etc. Co. v. Pacific F. Exp. Co.*, 11 Cal.2d 283, 79 P.2d 380, the application of the original sales tax law to a sale *351 at a fixed price entered into before its enactment, though it imposed a substantial burden upon the retailer, was held not to impair the contract. The court said: 'the principle of law is well established that the existence of an executory contract between or among two or more individuals presents no obstacle to the right or power of the state to levy or to impose a tax which may adversely affect the financial interests of either or any of the parties' (11 Cal.2d at p. 294, 79 P.2d at p. 386.) A recent statement of this rule appears in *Coast Bank v. Holmes*, 19 Cal.App.3d 581, at page 596, 97 Cal.Rptr. 30, at page 39, the general principle announced in the cases is that both existing law and 'the reservation of the essential attributes of continuing governmental power' are 'read into' all contracts 'as a postulate of the legal order.'

Western maintains that no such reservation may be 'read into' a public contract. It relies in this connection upon two decisions of the United States Supreme Court and one from the First Circuit dealing with public contracts, and a line of California cases concerned with the pension rights of public employees.

Murray v. City of Charleston, 96 U.S. 432, 24 L.Ed. 760 (1877), held unconstitutional an ordinance whereby, after issuance of interest-bearing municipal obligations, the city levied a general personal property tax which applied to them and empowered itself to deduct the tax from the interest payments. The opinion of the court, however, makes it clear that it was the provision for automatic collection from the particular class of taxpayer (creditors of the city) that invalidated the law. The provision for deduction of the tax from the interest payment was described as 'a change of the express stipulations of a contract, or a relief of a debtor from strict and literal compliance

with its requirements,' (96 U.S. at p. 444) and the court made it clear that the interest once paid could have been **235 taxed if it constituted properly having a situs within the city.^{FN5}

FN5. The holder of the municipal obligation in this case was a resident of Germany, and the court obviously did not think that there was any taxable asset in Charleston.

A more modern Supreme Court decision relied upon by Western is *El Paso v. Simmons* (1965) 379 U.S. 497, 85 S.Ct. 577, 13 L.Ed.2d 446. This case also involved legislation diminishing the rights of a party to a public contract, but in this case the legislation was upheld: the time within which a defaulting purchaser under a contract to buy public land could reinstate his contract, which had been unlimited, was cut to five years. Western's contention that the sole basis for upholding this impairment was that it constituted 'nothing but a modification of the remedy' is incorrect. The court expressly stated that it did not base its decision on that ground *352 but rather upon the proposition that 'it is not every modification of a contractual promise that impairs the obligation of contract under federal law, any more than it is every alteration of existing remedies that violates the Contract Clause.' (379 U.S. at pp. 506-507, 85 S.Ct. at 582.) The principle found to govern the case was stated by the court as follows:

' . . . The Blaisdell opinion, (*Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 54 S.Ct. 231, 78 L.Ed. 413) which amounted to a comprehensive restatement of the principles underlying the application of the Contract Clause, makes it quite clear that '(n)ot only is the constitutional provision qualified by the measure of control which the State retains over remedial processes, but the State also continues to possess authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end 'has the result of modifying or abrogating contracts already in effect.' *Stephenson v. Binford*, 287 U.S. 251, 276, 53 S.Ct. 181, 189, 77 L.Ed. 288. Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order. . . . This principle of harmonizing the constitu-

[6][7] Inasmuch as Western received the full fixed-price specified in its contract for the work, this contention amounts to the assertion that any increase in the tax burden incident to performance constituted an impairment of the obligation of its contract. Western concedes that an identical contract between it and a private owner would not be unconstitutionally impaired by any such increase. That concession is clearly required by well established case authority. In *National Ice, etc. Co. v. Pacific F. Exp. Co.*, 11 Cal.2d 283, 79 P.2d 380, the application of the original sales tax law to a sale *351 at a fixed price entered into before its enactment, though it imposed a substantial burden upon the retailer, was held not to impair the contract. The court said: 'the principle of law is well established that the existence of an executory contract between or among two or more individuals presents no obstacle to the right or power of the state to levy or to impose a tax which may adversely affect the financial interests of either or any of the parties' (11 Cal.2d at p. 294, 79 P.2d at p. 386.) A recent statement of this rule appears in *Coast Bank v. Holmes*, 19 Cal.App.3d 581, at page 596, 97 Cal.Rptr. 30, at page 39, the general principle announced in the cases is that both existing law and 'the reservation of the essential attributes of continuing governmental power' are 'read into' all contracts 'as a postulate of the legal order.'

C. Sovereign Acts Doctrine

The government may avoid liability for actions that are considered to be sovereign acts. This is based on the theory that government contractors should not benefit more than private contractors when the government passes a statute or takes other action affecting the public. This reasoning was explained in *Deming v. United States*, 1 Ct. Cl. 190 (1865), where one statute imposed additional duties on the contract articles included in the rations and another increased the cost of the articles. In denying the contractor's claims for recovery of its increased costs, the court stated at 191:

SOURCE:

Administration of Government Contracts
4TH Edition

By John Cibinic, Ralph C. Nash, James F. Nagle, Washington University.

C. Sovereign Acts Doctrine

The government may avoid liability for actions that are considered to be sovereign acts. This is based on the theory that government contractors should not benefit more than private contractors when the government passes a statute or takes other action affecting the public. This reasoning was explained in *Deming v. United States*, 1 Ct. Cl. 190 (1865), where one statute imposed additional duties on the contract articles included in the rations and another increased the cost of the articles. In denying the contractor's claims for recovery of its increased costs, the court stated at 191:

A contract between the government and a private party cannot be *specialy* affected by the enactment of a *general* law. The statute bears upon it as it bears upon all similar contracts between citizens, and affects it in no other way. In form, the claimant brings this action against the United States for imposing new conditions upon his contract; in fact he brings it for exercising their sovereign right of enacting laws. But the government entering into a contract stands not in the attitude of the government exercising its sovereign power of providing laws for the welfare of the State. The United States as a contractor are not responsible for the United States as a lawgiver. Were this action brought against a private citizen, against a body corporate, against a foreign government, it could not possibly be sustained. In this court the United States can be held to no greater liability than other contractors in other courts.

This reasoning was expanded upon in *Jones v. United States*, 1 Ct. Cl. 383 (1865), in which the contractor, who performed a survey, sought recovery for obstructions and hindrances caused by the government's withdrawal of troops in the area. The court noted at 384-85:

1. Public and General Acts

In judging whether a government act constitutes a sovereign act, the courts and boards frequently focus on whether the government act is directed at only the contractor or affects the public generally. In *Amino Bros. Co. v. United States*, 178 Ct. Cl. 515,

its place, and then the question be determined whether the action will lie against the supposed defendant. If the enactment of a law imposing duties will enable the claimant to increase the stipulated price of the goods he has sold to a citizen, then it will when the United States are defendants, but not otherwise. If the removal of troops from a district liable to invasion will give the claimant damages for unforeseen expenses, when the other party is a corporate body, then it will when the United States form the other party, but not otherwise. This distinction between the public acts and private contracts of the government—not always strictly insisted on in the earlier days of this court—frequently misapprehended in public bodies, and constantly lost sight of by suitors who come before us, we now desire to make so broad and distinct that hereafter the two cannot be confounded; and we repeat, as a principle applicable to all cases, that the United States as a contractor cannot be held liable directly or indirectly for the public acts of the United States as a sovereign.

1. Public and General Acts

In judging whether a government act constitutes a sovereign act, the courts and boards frequently focus on whether the government act is directed at only the contractor or affects the public generally. In *Amino Bros. Co. v. United States*, 178 Ct. Cl. 515, 372 F.2d 485, cert. denied, 389 U.S. 846 (1967), it was necessary for the contractor to construct a water crossing in order to perform its work on a flood control project. The

force); *Horowitz v. United States*, 267 U.S. 458 (1925) (Railroad Administration embargo delaying silk shipment); *Anthony P. Miller, Inc. v. United States*, 161 Ct. Cl. 455, cert. denied, 375 U.S. 879 (1963) (government's raising of interest rates); *Hills Materials Co.*, ASBCA 42410, 92-1 BCA ¶ 24,636, rev'd and remanded on other grounds, 982 F.2d 514 (Fed. Cir. 1992) (new excavation safety standard issued by Occupational Safety & Health Administration); *Inter-Mountain Photogrammetry, Inc.*, AGBCA 90-125-1, 91-2 BCA ¶ 23,941 (Department of Transportation denial of operating permit); *Mergentime Corp.*, ENGBCA 5765, 92-2 BCA ¶ 25,007 (delay ordered by Secret Service to facilitate presidential visit); *Holmes & Narver Servs., Inc.*, ASBCA 38867, 90-3 BCA ¶ 23,198 (congressional creation of new national holiday); and *Broadmoor Corp.*, ASBCA 37028, 89-1 BCA ¶ 21,441 (banning of pesticide by Environmental Protection Agency).

If an act that is sovereign in nature is motivated by a desire to avoid contractual liability, the sovereign act defense will not apply. See *Winstar Corp. v. United States*, 518 U.S. 839 (1996), holding that a statute prohibiting certain accounting treatment of bank assets was not a sovereign act. The government argued that its contracts promising such treatment were impossible to perform after the statute was passed and it was thereby not liable for breach of contract. The plurality opinion of the Court rejected this argument because the object of the statute was "self-relief," reasoning at 896-98:

If an act that is sovereign in nature is motivated by a desire to avoid contractual liability, the sovereign act defense will not apply. See *Winstar Corp. v. United States*, 518 U.S. 839 (1996), holding that a statute prohibiting certain accounting treatment of bank assets was not a sovereign act. The government argued that its

the United States as a sovereign. *Horowitz v. United States*, 267 U.S. 458 (1925).

given contractual commitment was no longer in the public interest, a govern-



CALTRANS AUTHORITY TO PAY FOR INCREASED SALES TAX

- California Constitution denies Caltrans the authority to pay for the increased sales tax:

Article 4, Section 17

*"The legislature has no power to grant, or to authorize a city, county, or other public body to grant extra compensation or extra allowance to a public officer, public employee, or contractor after service has been rendered or a contract has been entered into and performed in whole or in part, **OR** to authorize the payment of a claim against the State or a city, county, or other public body under an agreement made without authority of law."* (emphasis added)



CALTRANS POSITION (CONTINUED)

WAGE ORDER 16

- This dispute regarding sales tax rate increase is not equivalent to the WO 16 dispute.
- No effect on production and progress
- No effect on manner of work or means & methods
- Payment for WO 16 claims part of negotiated global settlements
- Sales Tax issue is contemplated in SS Section 7-1.03 "Payment of Taxes"
- Arbitration ruling is not Case Law



SUMMARY

The Contractor's claim has no merit based on the following:

- The dispute arose from events external to the contract.
- The Department is the only entity that can make changes to the contract.
- The Department has not breached or changed the contract.
- This increase in sales tax has no effect on the work.
- Construction Industry recognized that neither State laws nor State contracts have provisions for payment of tax increases which is why they tried to secure an exemption via AB 1523 and AB 2060.



SUMMARY (CONTINUED)

- The Sovereign Acts Doctrine allows the government to avoid liability for sovereign acts as long as they are public and general.
- Case law supports the Department's position.
- The Department has no legal authority to pay for these increased costs and cannot write a change order to pay for this claim.
- The contract specifically precludes the Department from issuing any document that would exempt the Contractor from paying any taxes.



Department's Summary

- DRB should abstain from making a recommendation for the following reasons:
 - External to the Contract
 - Legislative Act
 - Separate Contracts
 - Legal Principles/Case Law
- Specifications
 - SS 4-1.03 "Changes"- Only the Department can make a change to the Contract
 - SS 7-1.01 "Laws to be Observed"- Contractor is required to follow the law
 - SS 7-1.03 "Payment of Taxes"- Bid item price includes all tax. Can't write CCO to exempt ABF from taxes
 - SS 9-1.02 "Scope of Payment" – Contractor agrees to accept bid price for work contemplated and embraced Contractor is responsible for risks of every description connected with the prosecution of the work
- Legislation
 - AB 3 - 1% increase in existing sales tax rate
 - AB 1523 - Would have exempted fixed price contracts/Retroactive/Died
 - AB 2060 - Would have required CCO/Not Retroactive/Vetoed
- Legal: Not required to pay
 - Case law:
 - Western v BOE
 - McShain v District of Columbia
 - Deming v US

WHAT WE KNOW

ABF Position Paper Pages 22 of 24

- That State of California is a contracting party on the San Francisco Oakland Bay SAS Superstructure Project., not the Department of Transportation or the Board of Equalization.
- It was the intent of the California State Legislature that public works contractors be exempt from the 2009 increase in the Sales and Use Tax rate.
- In AB 2060, it was decreed that for a fixed price contract between a government entity and a contractor, the State is authorized to make payment for a change in the contract price that is attributable to a Sales and Use Tax rate increase.
- For over forty years public works contractors have been exempted from Sales and Use Tax rate increases.
- The Caltrans Construction Manual states that Contract Change Orders can be used to change any part of the original contract.
- The Caltrans Construction Manual states that Contract Change Orders can be used for administrative and other purposes
- The Caltrans Construction Manual states that Contract Change Orders can be used to make adjustments in compensation.
- Under California law, a covenant of good faith and fair dealing, that neither party will act in a way to compromise the rights of the other to receive the benefits of the contract, is implied in every contract.
- The only difference between a breach of an express promise to pay damages in the event of a change in the tax laws and the implied covenant of good faith and fair dealing is that the former is express and the latter is implied.
- The terms and conditions contained in ABFJV's Contract differ from those contained in the *Western Contract*.
- Under California law, each contract must be viewed in its own setting and applied to particular set of facts presented to court for consideration.
- California allows public works contractors to be compensated for changes in the law.
- Caltrans, on this Project has previously issued ABFJV Contract Change Orders for changes that do not affect the amount of the quality of the Work.

Agreed. The BOE is not a Contracting party on the Bay Bridge but is responsible for collecting taxes.

Not True. Both AB 3 and AB 2060 would not exempt the SAS project.

AB 2060 was vetoed by the Governor and therefore did not become law.

Agreed. However, it would be unfair to change SS 7-1.03 for this contract.

Agreed. Administrative claims typically refers to quantity disputes.

Agreed. A tax increase does not qualify as an adjustment in compensation.

The Department has not breached its covenant of good faith and fair dealing.

Quote is per *Centex v US* ruling, which is not applicable to this issue.

The specifications in question are similar- The Ruling is applicable.

True. However, the DRB is not a court of law.

All CCOs on the Project have been issued in accordance with the Contract.



WHAT WE KNOW

- Notwithstanding Standard Specifications, Section 7-1.01, "Laws to be Observed", Caltrans, in the past on this Project, has issued ABFJV Contract Change Orders for changes in California laws and regulations.
- The basis for this dispute is not a minor or irrelevant one. ABFJV's cost of performance was increased over four million dollars (\$4,000,000.00)
- When the government is acting as a private contracting party, the doctrine sovereign power does not apply, and the government's rights and duties are governed by the law applicable to private parties, unaltered by the government's sovereign status.
- The State has no basis on which to deny ABFJV Request for Contract Change Order No. 12.

No True. Changes to a contract required permit are not the same as a change to a tax law.

Agreed. However this issue is external to the Contract.

Not True. Case law has shown that the State can act as a Sovereign Power to increase taxes for the general good of the public and does not violate the Contract.

The Department Disagrees based on the contract specifications and applicable case law.

ABF has only put forward two main reasons:
Good Faith and Fair Dealing
Public Contract Code 7105

ABF now agrees that the 1% increase in sales tax is not a Change in Character of the Work

WHAT WE BELIEVE

- For the reasons set forth herein, American Bridge/Fluor Enterprises, Inc. is entitled to, and should receive a Contract Change Order increasing the Contract Price in the amount of the damages sustained by American Bridge/Fluor Enterprises, Inc. that were caused by the one percent (1%) increase to the State Sales and Use Tax rate for all purchases and payments made after April 1, 2009.



Court Cases Cited By ABF Indicate that this is a legal issue and external to the Contract

No.	Pg	Title	Case - Volume, Year
1	10	Mangindin v. Washington Mutual Bank	637F. Supp. 2D 700
2	10	Patriot Scientific Corp. v. Korodi	504 F. Supp. 2d.952
3	12	Centex Corporation v. U.S.	395 F.3d 1283
4	12	U.S. v. Winstar Corp	637 F. Supp. 2d 700
5	13	Western Contracting corp. v. State Board of Equalization	1974 39 Cal.App.3d 341
6	13	Dunne v. Colomb	1923 192 Cal. 740, 745-747
7	13	Colwell Co. V. Hubert	1967 248 Cal.App.2d 567, 575-576
8	13	R.J. Kuhl Corp. v. Sullivan	1993 13 Cal. App.4th 1589 17 Cal Rptr.2d 425
9	13	Butt v. Bertola	1952 110 Cal.App.2d 128
10	13	Alperson v. Mirisch Co.	1967 250 Cal.App.2d 84
11	14	DVD Copy Control Ass'n., Inc.v. Kaleidescape, Inc.	2009 176 Cal.App.4th 967
12	14	Kohn v. Kohn	1950 95 Cal.App. 2d 708
13	15	Teachers' Retirement Bd. v. Genest	2007 154 Cal App.4th 1012
14	15	20th Century Ins. Co. v Superior Court	2001 90 Cal.App.4th 1247, 1269
15	17	Horowitz v. United States	267 U.S. 458, 461
16	17	US. v. Winstar Corp.,	518 U.S. 839
17	17	Centex Corporation v. U.S.	395 F.3d 1283
18	17	US. v. Winstar Corp.,	518 U.S. 839
19	17	Amino Bros. Co. v United States	178 Ct. Cl. 515 372 F.2d 485 491
20	18	Travelers Indem. Co. v. First Nat. State Bank of New Jersey	328 F. Supp.208
21	18	U.S. v. Bostwick	94 U.S. 53
22	19	R.J. Kuhl Corp. v. Sullivan	1993 13 Cal. App.4th 1589 17 Cal Rptr.2d 425
23	19	Carma Developers Cal. Inc v. Marathon Developers California Inc.	2 Cal. 4th at p. 342
24	19	Foley	47 CAL .3d 654 254 Cal. Rptr.
25	21	New Jersey v. Yard	95 U.S. 104, 116-117
ABFJV's Rebuttal Paper			
26	R5	Windward Associates v. City of Hermosa Beach	(Windward) 2005 WL 2010275 (Cal App. 2 Dist)
27	R7	Yankee Atomic Elec. Co. v. U.S.	(Fed.Cir.1997) 112 F. 3d 1569,1579 cert. den 19
28	R8	Kimberly Associates v. U.S.	9th Cir. 2001 261 F.3d 864 869
29	R8	Laurel Hill Cementery v. City and County	1907 152 Cal. 464
30	R8	Interstate Marina Development Co. v. County of Los Angles	1984 155 Cal. App. 3 d 453
31	R8	Delucchi v. County of Santa Cruz	1986 179 Cal. App. 3d 814
32	R9	Teachers management & Inv. Corp. v. City of Santa Cruz	1976 64 Cal. App. 3d 438
33	R9	General Dynamics Corp. v. U.S.	Fed. Cl. 2000 47 Fed. CL. 514, 533
34	R9	Horowitz v. United States	1925 267 U.S. 458
35	R11	Kenney Orthopedic, LLC v. U.S.	88 Fed. Cl. 688 (2009)
36	R11	Rivera Agredano v. United States	70 Fed.Cl. 564 574n. 8 (2006)