

MEMORANDUM

State of Alaska Department of Law

TO: Michele Brown
Commissioner
Department of Environmental Conservation

DATE: October 6, 1999

FILE NO.: 661-00-0116

TEL. NO.: 269-5274

SUBJECT: Foregone Earnings on
Money Expended to
Contain and Cleanup an
Oil or Hazardous
Substance Release As a
Component of Cost
Recovery

FROM: Craig Tillery
Assistant Attorney General

The State of Alaska has long considered the lost or foregone earnings on amounts expended by the State to contain or clean up a release of oil or a hazardous substance to be a recoverable cost. Recently several responsible parties have questioned the legal basis for recovering lost earnings in addition to the actual amount of state expenditures. You requested our opinion as to whether, and at what rate, lost earnings are a recoverable cost.

Cost Recovery Statutes

AS 46.03.822 provides that the owner and person having control over a hazardous substance, as well as the owner and operator of a vessel or facility from which a hazardous substance is released, are strictly liable for the damages resulting from the release of the hazardous substance, including the costs of response, containment, removal, or remedial action incurred by the state. Damages are defined broadly to include "injury to or loss of persons or property, real or personal, loss of income, loss of the means of producing income, or the loss of an economic benefit." *Compare AS 46.03.822(k) with AS 46.03.824.*

The discharge of oil and hazardous substances is prohibited by AS 46.03.740 and AS 46.03.745, respectively. Under AS 46.03.760 a person who violates those provisions is liable to the state for a sum, not to exceed \$100,000 for the initial violation and \$5,000 per day. The amount is to reflect a number of factors including "reasonable costs incurred by the

state in detection, investigation, and attempted correction of the violation” AS 46.03.760(a)(2). Further, AS 46.03.760 provides that a person who violates AS 46.03.740 or .745 is liable to the state under AS 46.03.822 for “the full amount of actual damages caused to the State by the violation, including (1) direct and indirect costs associated with the abatement, containment, or removal of the pollutant . . . and (4) all incidental administrative costs.” AS 46.03.760(d).

Under AS 46.08.070(a) the Commissioner of the Department of Environmental Conservation (hereinafter “DEC” or “the Department”) is required to seek reimbursements for the costs incurred in the cleanup or containment of oil or a hazardous substance that has been released. In addition AS 46.08.070(b) requires the Attorney General to seek to recover money expended from the Oil and Hazardous Substance Release Prevention and Response Fund for purposes of containment and cleanup of oil or a hazardous substance.

Lost Earnings Are a Recoverable Cost

The cost recovery and damage statutes described above consistently require that the State fully recover its damages and costs arising out of the unpermitted release of oil or a hazardous substance. One of the economic losses that the State incurs as the result of an oil or hazardous substance release is the lost opportunity cost related to the money it is required to expend for containment and cleanup of the release. All public monies and revenue that come into the state treasury constitute the general fund of the State. *See* 1969 Op. Att’y Gen. No. 5 (April 15, 1969). Money held by the State in the general fund which is excess to that needed for immediate expenditure is invested by the State. AS 37.10.070; *see* 1987 Inf. Op. Att’y Gen. (Jan. 5, 1987) citing to Alaska Const., art. IX, sec. 16 (“The governor shall cause any unexpended and unappropriated balance [presumably of the general fund] to be invested so as to yield competitive market rates to the treasury.”). Earnings which accrue on general fund investments are available for appropriation for state expenditures. With respect to money expended from the State’s general fund in response to a release, potential earnings are no longer available to the State and thus constitute a direct loss to the general fund of the State.

The expenditure of money from accounts within the Oil and Hazardous Substance Release Prevention and Response Fund (“Response Fund”) to respond to a release directly adversely impacts the money available to the Response Fund for prevention and response activities. The Response Fund is composed of two accounts, the prevention account and the response account, which are available to contain, clean up, and take other necessary action related to a release. AS 46.08.040(a)(1)(A) and 46.08.040(a)(2)(A). The prevention

and response accounts are funded through various mechanisms, such as a surcharge on oil produced within the state (AS 43.55.201 and 45.55.300) and monies recovered by the State for fines, penalties, or damages for costs incurred by the State as the result of a release of oil or a hazardous substance. AS 46.08.020. Significantly, earnings on accounts within the Response Fund are credited to the prevention account and, upon appropriation, are available for expenditure from that account. AS 46.08.020(c). As a result of this statutory scheme, the lost earnings attributable to money expended from the Response Fund as the result of a release constitute not only a cost to the state treasury, but a direct loss of monies available to the Prevention Account within the Response Fund.

Recovery for the lost potential earnings on money owed is based on the notion that, to make a party whole, the party must be compensated for the earnings it could have made on the money for which it had a rightful claim during the period when the money was not available to it. *See McConkey v. Hart*, 930 P.2d 402, 405 (Alaska 1996). The economic rationale for compensating a party for losses attributable to that party's inability to use money is grounded on "the economic fact that money awarded for any reason is worth less the later it is received." *State v. Phillips*, 470 P.2d 266, 273 (Alaska 1970); *accord Ebasco Constructors, Inc. v. Ahtna, Inc.*, 932 P.2d 1312, 1317 (Alaska 1997); *Farnsworth v. Steiner*, 638 P.2d 181, 184 (Alaska 1981). "All damages then, whether liquidated or unliquidated, pecuniary or nonpecuniary, should carry interest from the time the cause of action accrues, unless for some reason peculiar to an individual case such an award of interest would do an injustice." *Bevins v. Peoples Bank & Trust Co.*, 671 P.2d 875, 881 (Alaska 1983).

Alaska courts often analyze the legal nature of a claim for the lost use of money in the context of prejudgment interest, finding that the concepts rest on the same economic rationale. Thus, courts hold that a party may recover the lost use of money either as a damage or as prejudgment interest, but not both. *See, e.g., Power Constructors v. Taylor & Hintze*, 960 P.2d 20, 37 (Alaska 1998); *Tookalook Sales and Service v. McGahan*, 846 P.2d 127 (Alaska 1993); *Pratt & Whitney Canada, Inc. v. Sheehan*, 852 P.2d 1173 (Alaska 1993); *Stevens v. F/V Bonnie Doon*, 713 F.2d 1433, 1438 (9th Cir. 1984).

In Alaska "prejudgment interest is a substantive right of an injured party, to allow that party to recover for economic loss occasioned by his inability to use the award of damages between the injury and judgment." *City and Borough of Juneau v. Commercial Union Ins. Co.*, 598 P. 2d 957, 958 (Alaska 1979). For that reason, awarding interest for the lost use of money due is properly classified as "an item of damage." *Guin v. Ha*, 591 P.2d 1281 (Alaska 1979); *Farnsworth v. Steiner*, 638 P.2d 181, 184 (Alaska 1981). In *Davis v. Chism*, 513 P.2d 475, 481 (Alaska 1973) the court noted that a plaintiff was entitled to "the

amount to which he has been damaged by the defendant from the date his cause of action accrued.” The court went on to state that “it may be argued that plaintiff was entitled to the use of that amount from the same date and the use of that money has real economic value, of which the plaintiff has been deprived.” *Id.* The court concluded by saying that “pre-judgment interest is necessary to compensate the plaintiff, not only by the amount by which he has suffered damages in the usual sense but also for the loss of the use of the money to which he has been entitled.” *Id.*

As described above, Alaska statutes confer an explicit right, and obligation, on the State to recover its damages, including costs, resulting from a release of oil or a hazardous substance. *See, e.g.*, AS 46.03.824 (damages include “the loss of an economic benefit”). Alaska law explicitly recognizes that the potential earnings on money due are a compensable item of damages. Thus it is clear that the State has the authority, and indeed the duty,¹ to seek to recover the foregone earnings on monies it is required to expend in order to respond to a release of oil or a hazardous substance.

Measurement of Lost Earnings

As discussed above, there are several ways in which the lost earnings due the State can be measured. First, they can be measured by a fixed “legal” rate of interest, such as that found in AS 45.45.010² and former AS 09.30.070. Although this method has the benefit of simplicity and ease of application, it is less likely to accurately reflect the actual cost to the State of the lost potential earnings. *See* Dan Dobbs, *Law of Remedies* Sec. 3.6(4) (2d ed. 1993); *accord*, *Report of the Governor’s Advisory Task Force on Civil Justice Reform* p. 28 (December 1996)(“The task force concluded that a fixed rate can create inappropriate incentives to delay or accelerate payment of a judgment or settlement, depending on the current interest rate environment.”). A more accurate measurement is derived from a market

¹ AS 46.08.070(a) provides that the Commissioner of the Department of Environmental Conservation “shall seek reimbursement promptly” for costs incurred in the cleanup or containment of a release. Subsection (b) of that section provides that the Attorney General shall “immediately seek to recover money expended by the department” from the Response Fund. This language is mandatory and does not allow discretion by the State to simply ignore reimbursement opportunities. However, by requiring the State to “seek” recoveries the law recognizes that in some instances other factors, such as the inability of a responsible party to pay for costs or legitimate issues concerning the strength of the State’s legal position, may cause the State to accept less than a full recovery.

² *See* 18 AAC 60.720

rate then current. *Dobbs, supra*, at 256. The market rate approach more closely approximates the actual costs to the State and is preferable.³ However, once one determines to adopt a market rate, the question remains as to how closely that rate is figured taking into account the differences in times of accrual of costs and the daily changes in interest rates.

In order to measure the exact losses attributable to the expenditure of State monies for response, one would establish the date of expenditure from a State interest-bearing account for each cost and, using the precise daily return rate for that account up until the date of repayment, calculate the earnings to which the State would have been entitled less any incremental costs of obtaining those earnings. This method would result in a calculation of the earnings equivalent to what would have been earned had the State not been required to expend the money. The primary problem with this methodology is the administrative time and expense required to track each cost from the particular date of expenditure through the date of repayment and to correlate that information with historical earnings of the account from which the money was expended. In most instances such costs will be incurred on a daily basis, creating a complex background for cost tracking and additional expense for both the State and the responsible party.

In the alternative, DEC may simply require payment of costs at a rate prescribed in a formula that approximates the potential lost earnings. This approach has been used in state statutes and approved by courts in Alaska for determining prejudgment interest rates. While the DEC is free to create a formula for this purpose it may want to consider those already in use in Alaska. The most familiar formula, AS 09.30.070(a), provides for prejudgment interest at a rate three percentage points above the 12th Federal Reserve District discount rate in effect on January 2 of the year in which the judgment is entered. As a trade-off for the ease of application of this formula, a certain precision is lost. For example, the rate in effect at the beginning of the year may be substantially higher, or lower, than the average rate for the year. In addition, the rate at the beginning of the year in which judgment

³ Some courts approach this problem through a restitution analysis. That is, they look to the gains of the person who retained the money and attempt to capture that benefit. *See Dobbs, supra*, at 255. Alaska courts recognize this element of prejudgment interest. *See Farnsworth v. Steiner*, 638 P.2d 181, 184 (Alaska 1981); *Anchorage Asphalt Paving Co. v. Lewis*, 629 P.2d 65, 69 (Alaska 1981). Although in many cases this analysis would yield a higher number, based on the internal rate of return of responsible businesses, the complexity and cost of administering this approach militates against its use. Moreover, its focus on the gain to the responsible party is inconsistent with the statutory emphasis on recovery of costs to the State.

is entered may not accurately reflect the average rate in effect for the period between when the loss occurred and when the judgment is entered. Nevertheless, the Alaska courts routinely apply this method as an acceptable approximation of the damages suffered through the lost use of money. *Cf., Power Constructors, Inc. v. Taylor & Hintze*, 960 P.2d 20 (Alaska 1998)(court approved statutory prejudgment interest rate of 10.5 percent under former AS 09.30.070 even though it varied from the actual rate of 11.5 percent incurred by the plaintiff).

Similarly, the formula in AS 09.30.070 provides an adequate approximation of the lost potential earnings to the Response Fund. For example, in calendar year 1998 the prejudgment interest rate under the formula in AS 09.30.070 was 8 percent. The overall rate of return for the State's General Investment Fund for the year was 6.96 percent. Assuming that the lost-earnings calculation for State costs begins to run at the time of billing, rather than at the time the expense is incurred, the prejudgment interest rate would come very close to the State's actual cost.⁴

In implementing the approach established for prejudgment interest, questions also arise as to what date to use in determining the applicable interest rate and on what date the interest begins to accrue. Since there is no judgment on which to base the date of the prescribed rate, we recommend that the interest rate for monies due for each calendar or fiscal year be determined based on the 12th Federal Reserve District discount rate on January 2 of each calendar year or July 1 of each fiscal year in which the cost is due. By adjusting the rate each year, a closer approximation of the actual costs will be achieved. We believe that interest should begin to accrue on the date on which notice is provided to the responsible party that money is due or owing. In most circumstances this date will be the date on which a bill or other notice is sent to the responsible party that identifies the expenditure and requests payment. To advance the State's interests in obtaining prompt repayment of costs, it is acceptable, but not required, for the DEC to agree to forego interest for the first 30 days

⁴ The statutory prejudgment interest rate is a simple interest calculation. *See Alyeska Pipeline Service Co. v. Anderson*, 669 P.2d 956 (Alaska 1983). As noted in *Dobbs, supra*, at 257, "if compounding of interest is the practice in the relevant market for borrowing or lending money, a rule against compound interest will insure that the interest awarded will fall short of compensation or restitution. In that case, compounding should be permitted." However, while it would be permissible to compound the interest calculation, as demonstrated by comparison of the statutory prejudgment interest rate with the General Investment Fund rate of return, the statutory formula allows for a sufficient return to account for the effect of compounding.

Michele Brown, Commissioner
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if payment is made promptly.

Conclusion

Alaska statutes permit and require the Department to recover the lost potential earnings on monies expended to contain and cleanup a release of oil or a hazardous substance. To establish the recoverable cost DEC may use the prejudgment interest formula in AS 09.30.070. DEC may base the formula rate on the appropriate discount rate on either January 2 of each calendar year or July 1 of each fiscal year for which the cost is owed. The date on which interest begins to accrue should be the date on which DEC provides notice to the responsible party that identifies the expenditure and requests payment.