

news letter

issue highlights

Volume XIV, Issue 1, Winter 2004

articles

- 1 Building Overseas? A Word to the Wise Regarding the Foreign Corrupt Practices Act**
- 6 Florida's New Construction Defect Legislation: Shortcoming and Problems**
- 9 Design-Build in the Public Sector: California Takes a Shot**

case notes

- 4 Public Bid Disputes: New Jersey Courts Provide Guidance on Key Issues**
- 10 Holding Subcontractors to Their Bid Quotes: Is There Any Recourse?**
- 11 The NUB—It's Not Just for Residential Construction**
In Re Enron Corp.

trend

- 7 Easy to Be Green?**
New York City says "Yes"

announcement

- 12 P&A Opens New Office Space in Fort Lauderdale**

Building Overseas? A Word to the Wise Regarding the Foreign Corrupt Practices Act

Headlines announcing the latest corruption scandal seem to be an almost daily occurrence. Driven to succeed, companies and individuals cut ethical corners. Enron's financial manipulations, Tyco's CEO's excesses and Martha Stewart's alleged insider trading compete for news space.

But while these complicated financial transactions seem to embroil the highest-level executives, international construction project managers also must be careful and knowledgeable to ensure that they and their companies are not the next headline. Understanding the U.S. Foreign Corrupt Practices Act¹ (FCPA) and its implications on international construction practice is, therefore, critical to successful, headline-free projects.

Recently turned 25 years old, the FCPA was born out of the wave of government reform that followed in the wake of the Watergate scandal of the mid-1970s. In 1976, the U.S. Securities and Exchange Commission issued its "Report on Questionable and Illegal Corporate Payments and Practices," which revealed that over 400 companies admitted to in excess of \$300 million in questionable or illegal payments to foreign government officials, politicians or political parties. Subsequently, Congress passed the FCPA in 1977 to thwart just those unethical payments. The FCPA was strengthened in 1999 with the passage of the International Anti-Bribery and Fair Competition Act of 1998,²

and then supplemented by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001,³ commonly known as the U.S. Patriot Act.

The FCPA and related legislation are designed to rout out corruption. While business practices in some countries tolerated payments to government officials, the political and business environments in other countries virtually required such payments to do business at all. Since the FCPA only restricts U.S. companies (and those subject to U.S. jurisdiction) from engaging in such acts, it initially was viewed as



ILLUSTRATIONS: LIAM ROBERTS

placing U.S. businesses at a competitive disadvantage to those companies not subject to similar restrictions. Since its passage, however, a great deal of effort has been put forth by various international organizations to battle the very types of corruption prohibited by the FCPA.

The Organization for Economic Cooperation and Development (OECD), an international organization of 30 industrialized nations, has been a leader in efforts to eradicate the practices of illegal payments to government officials. The OECD Convention to Combat Bribery of Foreign Public Officials in International Business Transactions went into effect on February 15, 1999, and its basic precepts were incorporated into the U.S. International Anti-Bribery and Fair Competition Act of 1998. In addition, numerous other organizations are also combating corruption, including the Inter-American

the “agents” definition and therefore include in their joint venture agreements prohibitions against actions that would violate the FCPA.

What actions violate the FCPA? It is important to understand that the FCPA is intended to prohibit “corruption,” not inhibit business. Thus, a gift not meant to influence, or obtain an unfair advantage is not covered by the act. The FCPA makes it unlawful to corruptly offer, pay, promise to pay or authorize the payment of any money, gift or anything of value to specified categories of foreign officials. Note that the restrictions relate not only to the offer or actual payment of anything of value, but to the “authorization” of such transaction. And, while a foreign subsidiary of a U.S. contractor arguably may not be covered by the act, its U.S. parent corporation, and the officers and employees who authorize such a payment certainly are covered. Moreover,

prohibits such payments for the purposes of: (i) influencing any act or decision of such [covered foreign individual] in his official capacity, (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or (iii) securing any improper advantage; or inducing such [covered foreign individual] to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

Note that prohibited payments are not simply those in which a quid pro quo has been reached; it also applies to “securing an improper advantage.” Examples of “improper advantage” include obtaining confidential information about a competitor’s bid or price or se-

curing an extension of time to submit a bid that is not extended to any other bidder.

If a payment is not intended to influence an official act or decision or gain an im-

proper advantage, therefore, it is not covered by the FCPA. But what such payments would not be corrupt and designed to influence an official act or decision? The FCPA exempts from its coverage payments for “routine governmental action.” Payments to “expedite or secure the performance of a routine governmental function” are not covered by the act. For instance, a payment to expedite the issuance of routine documents such as a license would not fall under the coverage of the FCPA.

In addition, the act sets forth several affirmative defenses. If an accused can prove that the payment was lawful under the “written laws and regulations” of the foreign official’s country, then no penalties will ensue. Similarly, no penalties will ensue if one accused of violating the Act can prove that the payment or offer was a “reasonable and bone fide expenditure, such as travel and lodging expenses... directly related to: (A) the promotion, demonstration, or explanation of products or services; or (B) the execution or performance of a contract

If an accused can prove that the payment was lawful under the “written laws and regulations” of the foreign official's country, then no penalties will ensue.

Convention Against Corruption, the United Nations Draft Convention Against Corruption and the Southern African Development Community Protocol on Corruption, to name only a few. It is clear that the international community is dedicated to eradicating illegal payments to government officials. What must also be clear to contractors are the restrictions placed upon them by the U.S. component of these various initiatives and how to operate within these restrictions.

First and foremost is the question: To whom does the FCPA apply? The FCPA applies to all companies that are subject to the U.S. Securities and Exchange Commission by virtue of having registered securities in the U.S. and to all “domestic” concerns, as well as the employees, directors, agents or stockholders acting on behalf of the domestic concerns. Therefore, it is safe to assume that if you are an American contractor, you are covered. In addition, most prudent contractors assume that their joint venture partners, even if not strictly within the above definition, are covered under

there is no comfort in borders. Even acts undertaken wholly outside of the United States by any “United States person” (defined as a U.S. national and any company or organization organized under the laws of or with a principal place of business anywhere in the U.S. or its territories) are covered by the act.

Payments or offers covered by the act, however, must be to certain categories of people for certain purposes. The payment must be made, promised or offered to a “foreign official”; “foreign political party, official thereof or candidate for political office”; or “any person, while knowing that all or a portion of such money or thing of value will be offered, given or promised, directly or indirectly, to any foreign official, to any foreign political party or official thereof, or to any candidate for foreign political office.” Thus, the act only applies to government-related individuals. Payments to private individuals are not covered unless it is known that they are intermediaries to governmental officials.

Consistent with the notion that the payments must be made “corruptly,” the act



with a foreign government or agency thereof.” (Of course, the reasonable and bona fide travel expenditure cannot extend to an official’s family or beyond the period necessary for performance of the contract.)

These affirmative defenses are, by their nature, very fact-specific inquiries, and the burden of proof falls on one accused of violating the act. Therefore, prior to making any such payments, an independent legal review of the facts and circumstances surrounding such a payment should be undertaken to determine if a violation of the act would result.

Since violations of the FCPA can result in hefty fines and civil penalties, as well as prison, for persons directly involved, what practical steps can a U.S. contractor take to protect itself against potential liability for violations of the act? There are several steps that any responsible contractor performing international work must take. First, is the adoption of a clear and unambiguous ethics policy that prohibits payments in violation of the act. The policy must explain the company’s position not only on prohibited bribes, but also on so-called

“facilitative” payments, which, while technically allowed under the act can be very difficult to defend under certain circumstances. Moreover, the policy must contain a safe mechanism for employees to report violations of the policy and should be clear that such “whistle-blowers” will be protected and not subject to retaliation. A compliance officer should be named in the policy with responsibility to ensure implementation of the policy as well as investigation of any reported or suspected violations of the policy. The policy should also contain a disciplinary procedure to be followed when a violation is found. Finally, the policy must be communicated to all responsible employees within the organization, along with adequate training on the proper implementation of the policy.

Second, an international contractor must have in place a regular and rigorous auditing process to ensure that no payments are made in violation of the act. Third, consortium and joint venture partners should be required to adhere to the same restrictions and level of controls as are contained in the policy. Finally, although it may be difficult to obtain in all

circumstances, similar restrictions should be placed on all subcontractors.

It should be noted that although the implementation of a policy and active investigation of potential violations are highly recommended, the FCPA contains no safe harbor provisions even if a contractor takes such actions. In other words, the implementation of a policy is not a defense to an FCPA violation. However, such a policy and active training will lessen the likelihood of a violation and may be considered by the prosecuting attorney as a mitigating factor.

In the wake of the Enron and other such scandals, and the increased awareness and action by numerous international bodies and governments, responsible international contractors cannot be without proper control mechanisms to prevent violations of the FCPA and related local regulations. The penalties are too high and the publicity too bad to ignore these issues, and to trust that all employees will act in the best interest of their companies. ❁

¹15 U.S.C. §§ 78dd-1, 78dd-2

²15 U.S.C. §§ 78dd-1, 78dd-3

³Pub. L. No. 107-56, 115 Stat. 272

Public Bid Disputes: New Jersey Courts Provide Guidance on Key Issues

Harvey Contracting, Co. v. Board of Education of Spring Lake Heights School District
Thomas P. Carney v. Franklin Township Board of Education
Seacoast Builders Corporation v. Jackson Township Board of Education

In three recent cases, the New Jersey courts have clarified some thorny public bidding issues on local public school projects. One case addresses the materiality of a self-perform percentage requirement; another addresses the proper

method for negotiating contracts after two rounds of bidding have resulted in contract prices that are over budget; and the third deals with the practice of post-bid selection of alternates and how this affects the low bidder's approved financial capacity.

Harvey Contracting v. Board of Education of Spring Lake Heights

In the first case, *Harvey*, Wallace Contracting Co. was awarded the contract over another bidder, Harvey Contracting Co. Although Wallace's bid was, in fact, the lowest, Harvey challenged the award to Wallace, citing a supplementary condition of the bid mandating that 35 percent of the work be self-performed by the general contractor. The intent of this provision is to prevent contractors from brokering the entire contract work.

In conforming to the bid requirement, Harvey stated it would use 41 percent of its own workforce, while Wallace mistakenly stated it would use

100 percent of its own workforce. Apparently, Wallace misunderstood the intention of the self-perform requirement and provided an itemized list of all of its subcontractors, line by line, in

had abused its discretion by allowing Wallace to refile the attachment with a corrected self-perform percentage.

It is significant that the self-perform requirement at issue here was subject to three critical reservations in the bid documents. First, the board reserved the right to waive any informality in the bids. Second, the board reserved the right to reduce the self-perform percentage at its sole and unfettered discretion. And, third, contractors were permitted to

The purpose of competitive bidding for local public contracts is to advance the public interest by securing the most economical result in the expenditure of public moneys.

order to explain what job each one was going to perform. Seeing the error, the board permitted Wallace to re-submit its breakdown post-bid. Harvey then argued that because Wallace could not possibly self-perform the entire contract, Wallace's bid contained a material deficiency that amounted to a failure in providing the self-perform attachment and/or providing a blank attachment. Harvey also argued that the board

submit a written request to the board to lower the self-perform percentage. Wallace therefore maintained that these reservations were a clear indication that a deficiency with regard to the percentage requirement would be deemed immaterial and thus waivable.

In making its determination the court adhered to the basic principle that the purpose of competitive bidding for local public contracts is not to protect the

individual interests of the bidders, but rather to advance the public interest by securing the most economical result in the expenditure of public moneys. Therefore, the court recognized that the erroneous attachment to Wallace's bid was immaterial because this requirement could be relinquished without there being any possible frustration of the policies underlying competitive bidding, and sustained the board's action in awarding Wallace the contract.

Carney v. Franklin Township Board of Education

In the second case, *Carney*, the court dealt with a challenge by the contractor who was the lowest bidder after the second round of bidding. In the two rounds of bidding, the prices exceeded the board's budget, resulting in the board's rejection of all bids twice, and the commencement of a negotiation process. Negotiation of public contracts is statutorily permitted as an exception to the requirement of public bidding when, after two rounds of bidding, the prices are in excess of the public entity's budget. The statute requires that all of the original bidders be allowed to participate in the process, but that the invitation to negotiate may also be extended to other interested vendors. (In this case, only the original bidders were invited back to participate in the negotiations.) The statute also requires that the contract that is ultimately awarded, cannot be substantially different from the original bid contract.

In an attempt to reduce the prices, the alternates, which were necessary for completion of the project, were made part of the base contract, and a number of value engineering items were added to the contract. However, after the first round of negotiations, the prices were still in excess of the budget. Therefore, more value engineering items were added to the package, and an additional alternate setting forth a reduced construction time was added in the anticipation that the reduced time would decrease the prices. This resulted in both the contract being within budget and its award to one of the original bidders.

Although the second-round lowest bidder, Carney, initially participated in

negotiations, it later dropped out of the process. In the bid challenge, Carney argued that the contract awarded after the negotiations was substantially different than what was originally bid. The court, however, rejected the challenge and ruled that a 4.16 percentage variation in the price between the lowest price in the second round of bidding and the negotiated price was not substantial. The judge stated, "[w]hile there is no bright line rule, a number approaching a 20 percent change would more easily evoke a label of substantial."

chose seven alternates and awarded the contract to Art Anderson, Inc (AAI), as the lowest bidder. The second-lowest bidder, Seacoast Builder's Corporation (Seacoast), protested on the basis that AAI's aggregate rating limit was less than its base bid plus the total cost of the 52 alternates that the board could potentially have selected.

The trial court sustained Seacoast's protest on the basis that there would be too much potential for contractor manipulation if the aggregate rating limit were based simply on the base bid

The court also noted that whatever manipulation may be possible was inherent in the nature of specifying alternates in the first place, a practice that is nevertheless accepted as a customary aspect of bidding.

The court's opinion noted that there was no change to the number of classrooms or square feet of the building, and that changes such as to provide one project sign rather than two, elimination of wire mesh in concrete slabs on grade and changes in manufacturer of the windows could not be considered substantial. Also noteworthy, although not mentioned in the opinion, is the fact that all participants were able to submit prices on the same scope of work, rather than having individual, "secret" negotiations in which varying scopes may be discussed and priced.

Seacoast v. Jackson Township Board of Education

The third case, *Seacoast*, presents a situation in which there was a challenge of an award to a bidder whose aggregate rating limit, the pre-bid financial qualification assigned to all bidders on public works, was not sufficient to cover the base bid and all of the potential alternates. The board had solicited bids for a new high school asking for prices on a base bid and 52 alternates. As is the practice and tradition, the board in its discretion would choose which alternates would be required at the time of the contract award. The board ultimately

rather than on the base bid plus all of the possible alternates. The trial court foresaw the possibility that the contractor could opt out, if alternates were selected that exceeded its aggregate rating limit. The board and AAI appealed. On appeal, the appellate court disagreed with the trial court, holding that the possibility of bidder manipulation was remote since the bidder would be required to perform if the alternatives actually chosen, something beyond the bidder's control, placed the bid within the bidder's capacity.

The court also noted that whatever manipulation might be possible was inherent in the nature of specifying alternates in the first place, a practice that is nevertheless accepted as a customary aspect of bidding. That is, a public entity can favor a bidder by its choice of contractual alternates, and this is without reference to the aggregate rating issue. Therefore, the court ruled that the objectives of public bidding to avoid corruption and favoritism, to encourage free and open competition on a level playing field, and to secure for the public the performance of the work by the lowest responsible bidder is not outweighed by the type of potential manipulation that the trial judge envisioned. ❁

Florida's New Construction Defect Legislation: Shortcomings and Problems

This past year, Florida enacted new legislation entitled "Construction Defects," in an attempt to reduce the number of lawsuits filed for faulty construction on residential properties. The statute grants

through the courts, that may not be enough incentive to give the law the teeth it needs to be meaningful.

Some law firms and consultants continue to beat the bushes for construction defect litigation, publicizing and

of Judgment Rule, allows any party to offer to settle through the entry of a judgment during the course of litigation. Generally, if the offeree denies the proposal, but ultimately does not recover as much as the offer, the offeree must pay

The new law does not contain any real incentives for construction professionals to make reasonable offers to fix defects and/or to settle claims, nor does it contain incentives for homeowners to accept reasonable, good faith offers that the construction professionals may propose.

construction professionals the right to obtain notice, inspect and offer to correct and/or settle claims for defective construction before any legal action is initiated. Unfortunately, in view of certain critical omissions, the legislation may fall short of accomplishing its stated purpose of bringing construction professionals and homeowners together to settle claims without resorting to lawsuits.

The problem is that the new law does not contain any real incentives for construction professionals to make reasonable offers to fix defects and/or settle claims, nor does it contain incentives for homeowners to accept reasonable, good faith offers that the construction professionals may propose. And while it is typically in everyone's best interest to attempt to resolve disputes and avoid time-consuming and often costly litigation, especially for residents who are forced to live with the defects for years while the litigation drags on

promoting jury verdicts against construction professionals and developers. The problem is exacerbated by the fact that many lawyers represent the homeowners on a contingency fee basis, getting paid only in the event of recovery. Naturally, potential claimants are lured by the promises of huge jury verdicts and the attractiveness of contingency fee agreements, which combine to make the risks associated with litigation appear minimal and the potential for recovery appear great. Thus, the desire to avoid litigation, standing alone, may not be enough to motivate potential homeowner claimants to accept good faith, reasonable offers to resolve and settle disputes.

The law should have included incentives such as the taxing of attorneys' fees and costs upon any party who fails to attempt in good faith to settle. For instance, Florida law, through what is commonly known as the Offer

of Judgment Rule, allows any party to offer to settle through the entry of a judgment during the course of litigation. Generally, if the offeree denies the proposal, but ultimately does not recover as much as the offer, the offeree must pay the costs incurred by the offeror since the date of the offer. This creates a strong incentive to accept reasonable, good faith offers and, likewise, creates an incentive for offerors to forward reasonable, good faith offers. Similar language, if contained in the new statute, would have the same effect and help resolve disputes, prior to litigation.

Another problem is that, deadlines contained in the law do not provide sufficient time for construction professionals to properly investigate and respond to the claims. The statute requires construction professionals to inspect the alleged defects within five business days after notice. Construction professionals receiving a notice are then required to forward notice of the claim to any subcontractor, supplier and/or design professional who may be responsible for each defect, within 10 days of the original notice. Finally, construction professionals must "offer to remedy," "offer to

comprise and settle the claim by making monetary payment,” and/or forward “a written statement that the [construction professional]... will not remedy the defect or comprise and settle the claim” within 25 days after receiving the initial notice.

To properly investigate and determine the cause, cost and potential remedy for alleged defects may require more than the 25 days allowed by the statute. This is especially true if destructive testing and the hiring of experts are required, both of which are not unusual. Likewise, 10 days may not be enough time to determine which subcontractors, suppliers and/or design professionals could be potentially responsible. Moreover, the construction professionals’ liability insurers and performance bond sureties may require and indeed have the right to participate in the process and to approve any settlement offer, offer to remedy and/or decision to reject.

As a result, two things will likely occur. First, the construction professional will be forced to forward the claim to each and every subcontractor, supplier and/or design professional who worked on the project to ensure that any potentially responsible party is provided notice within the required time period. This may result in parties receiving notice who are ultimately determined to have no liability for the alleged defects. Second, construction professionals may be forced to refuse to offer to remedy the defect or to compromise and settle the claim since the time provided is insufficient to properly investigate the alleged defects. A provision for requesting an extension of time to investigate alleged defects, to notify other potentially responsible parties and to make an offer should be added to the statute, and claimants should have some incentive to grant reasonable requests for the extension of time.

Nevertheless, only time and experience will be the ultimate judges as to whether or not the new law aids construction project participants and slows the need and the trend for litigation of these homeowners’ claims. Although there are pitfalls, it is certainly a step in the right direction. *

Easy to Be Green?

New York City says “Yes”

One of the greatest demands on the construction industry in recent years is to create more environment-friendly building structures. Many companies have been hesitant due to the added costs and technical difficulties in creating “greener” buildings. However,

there are innovations in the New York metropolitan area that have implemented various conservation measures at minimal cost, thereby challenging Kermit the Frog’s lament, “It ain’t easy being green.”

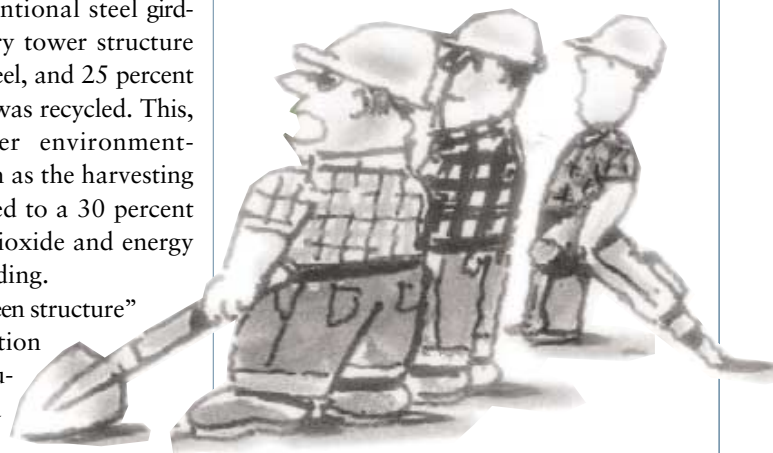
The remodeling of the Hearst Building, located in Manhattan, at 959 Eighth Avenue, will certainly be the model for future “green” commercial building designs. This structure not only appeals to the eye but also reduces emitted pollutants. By using a diagrid system, which features a diagonal grid of steel, as

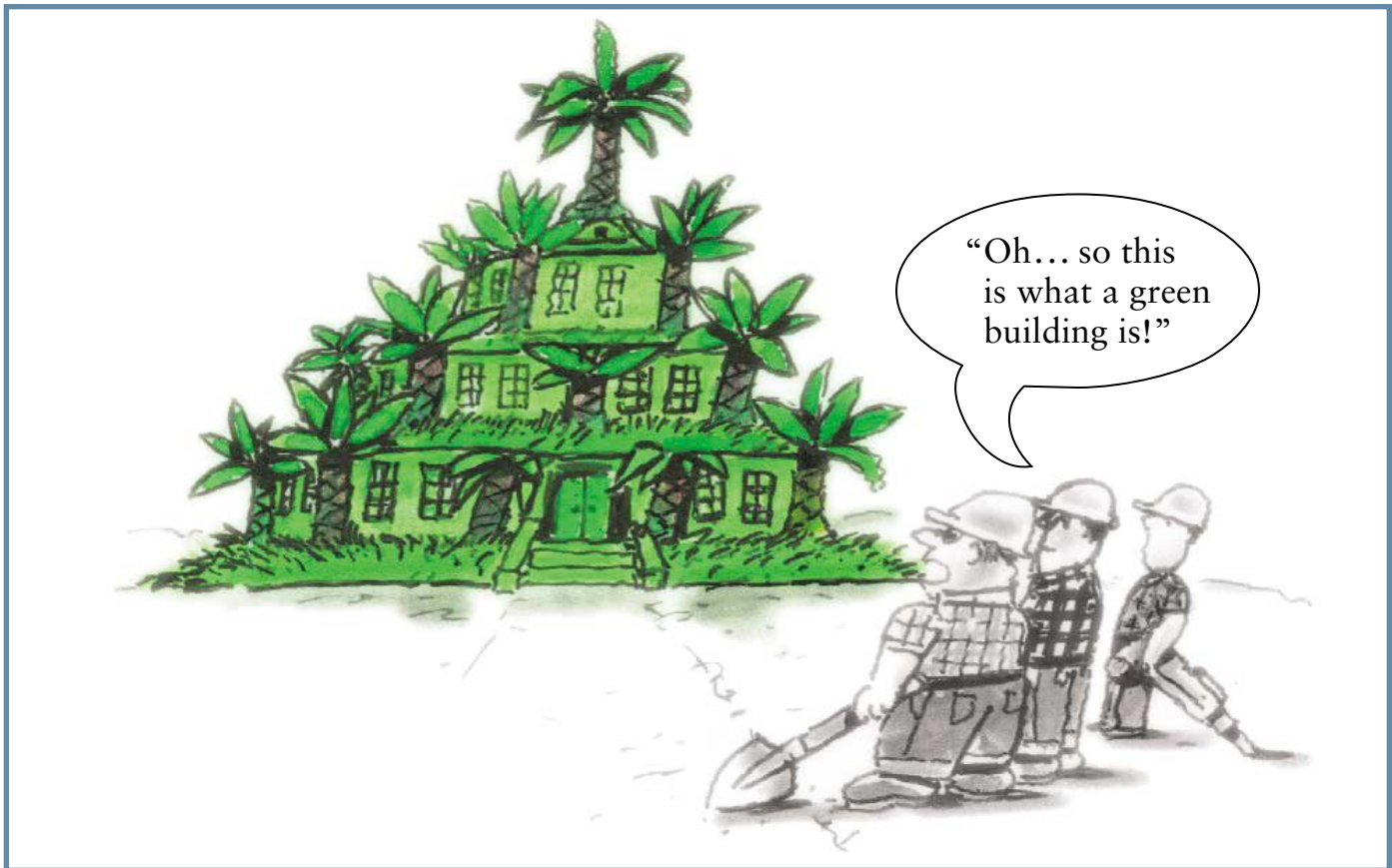
to gain momentum. Over the past 10 years, the New York City public school system’s green design program has greatly contributed to the use of conservation technologies. Schools are now being built on an east-to-west axis to harvest the natural solar lighting. They are also using geothermal heat to cut energy costs by using the earth’s 55-degree base as an initial source of heat. And the biggest innovation in school construction is the “green roof system.” By using an upside-down terrace where plants can be grown, water piping is reduced

Over the past 10 years, the New York City public school system’s green design program has greatly contributed to the use of conservation technologies.

opposed to the conventional steel girder system, the 42-story tower structure used 21 percent less steel, and 25 percent of the total steel used was recycled. This, combined with other environment-friendly measures such as the harvesting of natural light, has led to a 30 percent reduction in carbon dioxide and energy consumed by the building.

This magnificent “green structure” is no longer the exception in the building community, but highlights a trend that continues





by 75 percent as more water is retained by the natural greenery. The green roof also reduces heat by 20 to 30 degrees in the summer over the conventional blacktop that absorbs heat. In addition, it gives inner-city children a chance to play on a large area of grass

leased. The Solair met the Gold LEED (Leadership in Energy and Environmental Design) standard. This acknowledgment indicates that the Solair is 35 percent more energy-efficient than the average New York City residential structure and, therefore, is eligible for tax credits.

time when the air is drier. The benefits of these green features are apparent to one family with a seven-year-old girl who had respiratory problems prior to living in the building. Now, less than a year later, the child no longer suffers from these problems. The success of the first green residential building is a continuing story, as these same innovators now plan on constructing a second green building, which will use the excess capacity of the water treatment facility at the Solair.

Now that the ground for these green buildings has been broken, the biggest concern of the New York City government is how to get this message across to the building community as a whole. The government is seeking to establish that it itself is not a barrier to the construction of these greener buildings. In fact, through the tax credit program, the government is trying to encourage the development of green buildings. While, the largest impediment is the economic concern, the initial costs can be offset by the tax credits and the return on investment through lower operational costs. With all of this coming into play, the Hearst Building and other green buildings are proving that... it's easy to be green. ⚙️

Now that the ground for these green buildings has been broken, the biggest concern of the New York City government is how to get this message across to the building community as a whole.

and is generally, more aesthetically pleasing. Schools that at one time were getting old within 20 years are now more durable and have increased value, and initial green costs are compensated within six years due to energy savings.

In conjunction with the success of the green school construction program, residential builders have also seen opportunities to incorporate greener designs. In Battery Park City, the Solair, the first green residential high-rise in the country, opened last July and is already 80 percent

The ingenuity of the designers and architects of the Solair produced many of the environment-friendly features of the building. For example, each unit of the building has an on/off electrical switch, located near the front door so a resident can shut all power off when leaving the apartment. They have eliminated the need for potable water in the toilet by introducing a recycling system. In addition, contrary to most of New York City's buildings, this building pumps fresh air for ventilation and even humidifies the air in the winter-

Design-Build in the Public Sector: California Takes a Shot

A relatively recent provision in California's Education Code allows California's K-12 school districts to enter into design-build contracts for construction of schools costing in excess of \$10 million. A more recent amendment expanded this option to certain community college districts such as those in Los Angeles and San Jose.

Previously, California law had required school districts to award any construction contracts above a paltry

Over the last year, there has been a frenzy of interest, debate and activity regarding the design-build construction of California schools. What are the pros and cons of design-build in this context, and what are the results of this new project delivery system for California educational facilities?

How Does the New Law Work?

The following six points summarize the key guidelines and requirements of the design-build option:

- Requires that a school district governing board conduct a public meeting

with specified information, obtained under oath; and establishment of a procedure for final selection of the design-build entity based on either a competitive bidding process resulting in lump-sum bids, or based on performance and other criteria set forth by the local board to determine best value.

- Specifies that retention proceeds withheld by the design-build entity from a subcontractor may not exceed the amount withheld from the design-build entity by the school district.
- Requires the school district to employ the project inspector, who shall be fully independent of the design-build entity.
- Requires that the design-build performance criteria and design standards established by a school district be adhered to by the design-build entity, with deviation only allowed in writing.
- Requires that the design-build entity shall be liable for building the facility as set forth in the contract and shall assume the risk of any cost overruns.

Over the last year, there has been a frenzy of interest, debate and activity regarding the design-build construction of California schools.

threshold of \$15,000 to the lowest responsive, responsible bidder. Architectural services contracts, on the other hand, were awarded on the basis of demonstrated competence and professional qualifications to be performed at a fair and reasonable price, not necessarily to the lowest bidder. Prior to the adoption of the design-build option, California schools, and most public construction work, were built using a traditional design-bid-build project delivery system.

prior to entering into a design-build contract and make written findings that the design-build process will meet one or more specified objectives.

- Requires that creation of a design-build contract progress in a three-step process: preparation of a request for proposal setting forth the scope of the project and other specified components including the methodology for evaluation of proposals; establishment of a procedure to prequalify design-build entities, including the use of a questionnaire

Risks and Rewards

In theory, design-build defuses the sometimes adversarial relationship between designers and builders, and reduces the number of formal change orders, with delays and valuation disputes as a result of the "same team" approach.

The most apparent risk for the contractor is inflation of the scope and quality of a project and **continued on page 12**

Holding Subcontractors to Their Bid Quotes: Is There Any Recourse?

Bunkoff General Contractors, Inc. v. Dunham Electric, Inc.



General contractors often formulate their bids to owners on the basis of quotations from potential subcontractors for various components of the work.

However, rarely do the general contractor and the subcontractors sign subcontract at the time the quote is provided, even one contingent upon the general contractor being awarded the job. The subcontractors provide a price either in writing or orally, and the understanding is that if the general contractor obtains the contract, it will sign a subcontract with one of the subcontractors that sent in bids, usually the lowest bidder. What happens, though, if the subcontractor refuses to take the job? There is no written contract, and, while the subcontractor's bid is an offer to perform the work, there may not even have been a contingent acceptance of the offer from the general contractor. Nevertheless, there may be a remedy for the general contractor who is compelled

to enter into a subcontract with someone else at a higher price.

In a recent New York case, *Bunkoff General Contractors, Inc. v. Dunham Electric, Inc.*, the general contractor sued the subcontractor for the increased cost incurred in contracting with a different subcontractor when the low bidder refused to perform. The lawsuit was based on a legal doctrine called promissory estoppel. To recover damages based on this theory, the general contractor must prove the following: (1) the subcontractor made a clear and unambiguous promise (i.e., a definite bid); (2) the general contractor relied on the bid (by incorporating it in the bid to the owner); (3) the general contractor's reliance was reasonable and foreseeable (the subcontractor knew the general contractor would formulate its bid with the subcontractor's price); and (4) the general contractor was damaged as a result of its reliance the contractor had to pay a higher price for the same work.

In *Bunkoff*, the general contractor asserted that it relied on the subcontractor's initial bid in submitting its own bid to the owner, and then relied on the subcontractor's revised cost proposal to respond to the owner's request to find ways to reduce the price. The general contractor claimed that at both stages it told the subcontractor that it would be awarded the job as long as the owner awarded the job to the general contractor. While the subcontractor disputed this assertion, its main contention was that there was no legal basis for the general contractor's claim since no contract had been signed. The court rejected the subcontractor's contention, ruling that if a general contractor can prove the four elements, it has a viable claim against the subcontractor.

Prior to the *Bunkoff* decision, this type of claim had received a mixed reception in the New York courts. One trial-level court questioned the viability of a general contractor's promissory estoppel claim against a subcontractor, but ultimately held that, regardless, the general contractor could not recover because it had attempted to negotiate a different price with a different scope of work from the subcontractor. On the other hand, another trial-level court ruled in the general contractor's favor on this type of claim. The *Bunkoff* case is the first appellate-level decision in New York explicitly accepting a bid reliance claim by a general contractor against a subcontractor. ❁

EDITOR'S NOTE:

Courts in many other states have considered a promissory estoppel bid claim. For instance, the California courts have explicitly accepted this type of claim. The New Jersey courts have indicated that, if the appropriate facts are proven, a general contractor could prevail on this type of claim. And, in Florida, the courts have recognized the applicability of the doctrine of promissory estoppel from the subcontractor's point of view, ruling that a general contractor that subcontracted with another, after utilizing the subcontractor's bid in formulating its own bid to the owner, could be liable for damages to the subcontractor.

The NUB – It's Not Just for Residential Construction

In Re Enron Corp.

All too often on commercial construction projects, a contractor is faced with the possibility of nonpayment as a result of bankruptcy. Whether it be the general contractor or the project owner that files for bankruptcy, the risk of nonpayment to a contractor is always present. Indeed, in recent years, the unexpected bankruptcy filings of Enron and MCI, among other *Fortune* 500 companies, have left many construction project participants out in the cold and looking for a surety bond or another way to assert lien rights to recover payment. However, under the lien laws of some states, a lien placed after the bankruptcy petition is filed may be too little and too late to protect the contractor.

Although the courts in New Jersey have not yet ruled on this issue with respect to the Construction Lien Law that was enacted 10 years ago, a recent decision in the United States Bankruptcy Court for the Southern District of New York provided its own interpretation. In this case, an electrical contractor performed work at a paper mill that was owned and operated by a subsidiary of Enron Corporation. Enron, as the world knows, filed its voluntary petition for relief under the bankruptcy code in December 2001. Shortly thereafter, swept in and swallowed up by the Enron filing, the paper mill subsidiary filed its own petition with the bankruptcy court. The day after the paper mill filed its petition, the electrical contractor recorded three construction liens against the paper mill's property for work that was performed prior to the bankruptcy filing. Many other contractors subsequently followed suit and filed their lien claims. Only one contractor had filed its lien prior to the bankruptcy petition.

Ordinarily, a valid construction or mechanic's lien gives rise to a secured claim in the bankruptcy proceeding. This type of claim is preferable — as it results in much

more favorable treatment than the unsecured claims of general creditors. However, the bankruptcy code allows the debtor to avoid having to treat post-bankruptcy petition construction and mechanic's lien claims as secured claims if the applicable state law does not allow the lien claims to relate back to a time prior to the filing of the bankruptcy petition.

In a proceeding to establish that its post-petition lien filings were secured claims, the electrical contractor argued that its post-petition liens related back to the pre-petition date upon which it first performed services, rather than to the

File Lien (NUB). Once a contractor files a NUB, any subsequent filing of a lien claim specifically relates back to the NUB filing. Mandatory for residential claims, NUBs may, at the contractor's option, be filed on commercial projects, and are a handy protective device for contractors to protect their lien rights when they suspect an impending bankruptcy or a transfer of property. Indeed, it was the availability of the NUB as a protective remedy that led the court to conclude that the post-petition liens were not secured claims, the court reasoning that the contractor could have filed the NUB pre-petition to secure its

The unexpected bankruptcy filings of Enron and MCI, among other Fortune 500 companies, have left many construction project participants out in the cold.

post-petition date of the lien filing. In the alternative, the contractor argued that the post-petition filing of its lien related back to the lien fund that was created by the pre-petition lien filing of the one contractor. The court rejected both arguments, finding that under New Jersey's Construction Lien Law, a lien claim does not attach to the interest of an owner until the filing of the claim. With respect to the electrical contractor's second argument, the court ruled that only a valid lien claimant may participate in the lien fund created. In making its ruling, the court recognized that the Construction Lien Law provided for a little-used device, the NUB, which, if timely and properly employed by the contractor, would have made the lien relate back, and thus be a valid, secured claim.

As residential contractors know, before a lien claim may be filed against residential property, one step that the contractor must take is to file a document entitled the Notice of Unpaid Balance and Right to

lien claim. Had any of the paper mill contractors filed a NUB before the paper mill's bankruptcy filing, the contractors' post-petition lien claims would have related back to the pre-petition NUB and thus would be valid, secured claims against the debtor. ❁

EDITOR'S NOTE:

The New Jersey Construction Lien Law provides that the filing of a NUB is purely optional for commercial construction, while mandatory for residential. The NUB's beauty is that it does not have to be served on any party, and it preserves a contractor's lien rights. However, the NUB is only effective for 90 days, and it is not a substitute for a lien filing. It only allows the lien, once filed, to relate back to the time the NUB was filed. Commercial contractors should be mindful of the NUB as a weapon in the contractor's arsenal to enforce valid claims for payment, especially with rumors of bankruptcy in the air.

continued from page 9 the resultant impact on cost and schedule. In a typical construction contract, the contractor is usually entitled to a change order when

against its design firm partner or sub-consultant, depending on the contract. Architectural/engineering firms inexperienced with design-build parameters

Once the design-builder assumes responsibility for the design, it also assumes responsibility for the accuracy of the drawings and specifications.

there is a change to the scope of work, changed conditions, or errors or omissions in the plans and/or specifications.

In a design-build contract, the design-builder may be entitled to a change order when the public owner requests certain changes in scope or when unforeseen conditions are encountered; but since the design-builder is responsible for the design, plans and specifications, it cannot claim entitlement to a change order as a result of its own errors or omissions.

Once the design-builder assumes responsibility for the design, it also assumes the responsibility for the accuracy of the drawings and specifications. However, a general contractor who has contracted for the design services may bring an errors and omissions claim

face licensing, bonding and insurance limitations that they may not have previously considered.

Although California is currently suffering through a budget crisis, many school projects are already funded, and school bond measures are working their way onto the ballot at the state and local levels. With more than 1,000 school districts and 108 community college districts in California, 700 future schools projects have already been identified. Contractors may find that these new design-build laws can provide a steady stream of potential business in an otherwise tepid construction economy. The most apparent reward for contractors is a potential \$30 billion market over the next five to seven years.

For the public owner, the risks of design-build include a misconception of the pros and cons, inexperience on the part of the school district in administering this type of project, less control, potentially higher costs, more administration and public involvement, expedited decision making and disagreement on the inspector.

As for rewards, the public owner may benefit from simplified contracting and contract administration, cost containment, a reduced number of change orders, a less adversarial relationship, time savings, earlier cost definition, greater risk shifting, a more efficient allocation of risks, and an alternative selection process. ☼

Peckar & Abramson

**Peckar & Abramson
Opens New Office Space in Fort Lauderdale**

On March 1, Peckar & Abramson will open a new office in the Las Olas City Center in the heart of downtown Fort Lauderdale, Florida, to better serve its clients in the greater Fort Lauderdale and Palm Beach areas. Melinda Gentile will be the partner in charge.

**401 East Las Olas Boulevard
Suite 1600
Fort Lauderdale, Florida 33301**

**Telephone: (954) 764-5222
Facsimile: (954) 764-5228**



Peckar & Abramson Newsletter
Volume XIV, Issue 1, Winter 2004

Charles F. Kemy, Esq., Editor

Peckar & Abramson, P.C.

Attorneys at Law

New Jersey
70 Grand Avenue
River Edge, NJ 07661
Telephone: (201) 343-3434
Facsimile: (201) 343-6306

New York
546 Fifth Avenue, 17th Floor
New York, NY 10036
Telephone: (212) 382-0909
Facsimile: (212) 382-3456

San Francisco
250 Montgomery Street, 16th Floor
San Francisco, CA 94104
Telephone: (415) 837-1968
Facsimile: (415) 837-1320

Los Angeles
555 West Fifth Street, Suite 3000
Los Angeles, CA 90013
Telephone: (213) 489-9220
Facsimile: (213) 489-9215

Miami
One Southeast Third Avenue, Suite 3050
Miami, FL 33131
Telephone: (305) 358-2600
Facsimile: (305) 375-0328

Fort Lauderdale
401 East Las Olas Boulevard
Suite 1600
Fort Lauderdale, FL 33301
Telephone: (954) 764-5222
Facsimile: (954) 764-5228

E-mail: mail@pecklaw.com
Web site: www.pecklaw.com

© Copyright 2004 by Peckar & Abramson, Attorneys at Law.
Permission to reprint granted with appropriate credit.

This newsletter provides general information only. It is not legal advice and should not be used as a substitute for review with counsel of your specific situations.

Designed by Shostak Studios, Inc., NYC.