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What do words like "corruption", "waste", "public contracts", and "school construction" have in common? While the answer was in virtually every New Jersey newspaper last year, their relationship apparently escaped the attention of the judges who authored the opinion in *William Scotsman, Inc. v. The Garfield Board of Education*. For the court's failure to realize why public bidding is so important, and how it helps the construction industry as well as the taxpaying public, this opinion clearly earns a richly deserved Galloping Gertie Award for the worst analyzed New Jersey construction law case of the past year.

The court's decision answered a question which it never should have asked: when the government enters into an illegal public works contract, and it then decides to follow the law by refusing to honor the contract, the government must still pay damages for the contract's breach. Scotsman had entered into an agreement for it to specially manufacture and lease portable preschool classrooms to the Garfield Board of Education. First, the Board passed a resolution to authorize this purchase. Then, the contract was signed by the Board's secretary/business administrator and initialed by the superintendent of schools. The Board also obtained a good price on some really nice classrooms, and there was "not the slightest hint of impropriety" in the negotiation. What was missing, however, was an attempt to publicly advertise the contract or award it to the lowest responsible bidder even though the law included no relevant exceptions to required bidding, such as the "emergency exception".

Worst Construction Law Case of the Past Year

Scotsman also knew that something seemed wrong. The State of New Jersey was buying portable preschool classrooms for the same program and Scotsman had to bid for that work. When Scotsman brought this to the attention of the Board's aforementioned secretary/business administrator, it was wrongly assured that the Board could proceed without public bidding.

After Scotsman had finished the classrooms, the Board refused to pay for them. Grant funding was supposed to come from the State, but when the State discovered that the Scotsman contract had been awarded without public bidding, the State refused to go forward with the grant. When the Board then refused to go through with its unlawful contract and pay for the classrooms, Scotsman sued to recover damages.

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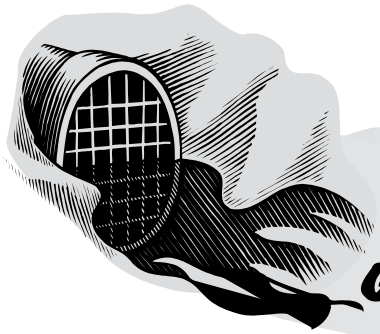


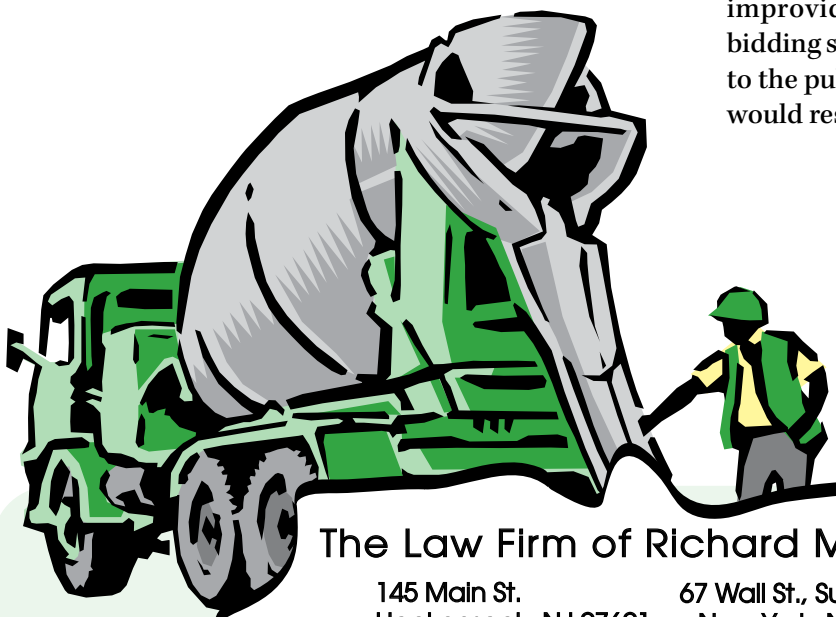
Galloping Gertie

Finding in favor of Scotsman, the court's opinion repeated a virtual mantra about the importance of public bidding. Furthermore, the court flatly stated that the public bidding laws did not authorize the contract. Nevertheless, the court upheld the contract based on "equitable estoppel". Estoppel is an old word which means "stop". Thus, an equitable estoppel stops a party "from taking a course of action that would work injustice and wrong to one who with good reason and in good faith has relied upon such conduct."

The court continued by stating that estoppel had been applied against government action in some cases even when the law would not support the government's action. Since the Board had assured Scotsman that the transaction did not require public bidding, the Board had actually obtained a superior product, and there was no hint of impropriety, the court stopped the Board from reneging on the contract and decided that the Board had to pay damages for its breach.

What is terrible with this court's approach is that Scottsman's win is a loss for everyone else. By claiming estoppel, a government agency can now assert ignorance of the public bidding laws to award contracts to "favorite sons" and deny every other potential bidder the right to win a contract. Honest but ignorant government bodies can be cajoled into buying inferior services at superior prices. Or, a shady deal in the back room can produce a worse bargain. Furthermore, proving "impropriety" is tough because people hide this sort of conduct. And Scotsman was not all that innocent—the company knew the State was seeking competitive bids for the same kind of work. Why didn't someone get a lawyer's opinion?

The court also ignored the letter of the law. While a few modern decisions have applied equitable estoppel when there is a small public bidding irregularity, estoppel is not supposed to be used to frustrate an essential purpose of a law or to ignore a mandatory prohibition in the law. For contracts above a certain dollar amount, and in the absence of a specific legal exception, the Public Schools Contracts Law states that "every contract", "shall be awarded only by resolution of the board of education to the lowest responsible bidder after public advertising... ." Similar language is in other bidding statutes. The New Jersey Supreme Court has also emphasized the importance of public bidding: "the purpose of the public bidding requirement is to 'secure for the public the benefits of unfettered competition' and to 'guard against favoritism, improvidence, extravagance and corruption'." "Public bidding statutes ... should be construed with sole reference to the public good." One would think that these principles would resonate today—apparently not.



The Law Firm of Richard M. Baron

145 Main St.
Hackensack, NJ 07601
(201) 883-1600
fax (201) 883-1616

67 Wall St., Suite 2411
New York, NY 10005
(212) 709-8044
fax (212) 943-2300

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Bond Claims

Under New Jersey's public works payment bond law, no subcontractors or suppliers to a subcontractor have payment bond rights unless they give the general or prime contractor a written notice, within 20 days after starting work, stating they are a potential beneficiary of the bond. In *Dial Block Co. v. Mastro Masonry Contractors*, a stiff-necked legal analysis elevated form over substance when a court decided that a joint check agreement between a subcontractor's supplier and a GC did not meet this requirement. While acknowledging that the policy behind the law's notification mandate was to reduce the GC's uncertainty about the identity of all potential bond claimants, the fact that the GC had been paying some of the supplier's bills under the agreement was not enough. Instead, this opinion decided that the law requires a separate piece of paper. Warning: Don't confuse this requirement with a second "demand for payment" notice on New Jersey and Federal public works projects. The details differ, but they can be met with a written demand for payment to the GC and surety, by certified mail, within 90 days of completion of the unpaid party's work. New York law is similar to Federal law, but New York allows 120 days instead of 90 days.

Public Bidding

New Jersey's public bidding laws do not permit specifications to unfairly favor local businesses over outsiders. Nevertheless, it still takes courage for a court to look behind a seemingly unbiased statute for hidden favoritism and then throw out the law when bias is actually discovered. In *DeFalco Instant Towing, Inc. v. Borough of New Providence*, a new Borough law required "primary" towing companies to be located in the Borough for the stated purpose of obtaining an early call response. But under an earlier law, two towing companies from neighboring towns had always been able to respond within the same time period as two companies from the Borough. Furthermore, the police department had the authority to designate towing companies, and the department clearly expressed its view that the outside companies were just as quick to respond. There was also evidence that one Borough company sought this new law for the purpose of locking out competition. In these circumstances, the court decided that even though laws carry a "presumption" of being "legal" , the evidence in this case was so strong that the supposed purpose of the law was just a subterfuge to hide the real intent of favoring local companies. So, the court threw it out. Good call.

Personal Liability

In typical situations, a company's debt to a contractor will not be charged to the company owner even if the owner takes money from the company which might relate to the contractor's work. In *Advanced Enterprises Recycling, Inc. v. Martin Bercaw*, an individual named Bercaw owned three landscaping companies who purchased wood mulch products from companies owned by Peterpaul. One of Bercaw's companies collected over $100,000 for the mulch it sold, but it did not pay a Peterpaul company for the products. Instead, Bercaw apparently had his company transfer almost all the money to his family and himself. The court found that Bercaw was not personally liable even though his companies did owe the money to the Peterpaul company because the $100,000 was not explicitly "earmarked" or segregated as a "trust fund" for the Peterpaul company. Since the amount was only a debt to the Peterpaul company, Bercaw had no personal obligation to assure that his company paid the Peterpaul company. Thus, he was not personally liable for "conversion".

Unlike this New Jersey case, funds can be "trust funds", and subject a company owner to personal liability on any public works or New York projects.

Wrestling with Liquidated Damages

A contract's "liquidated damages" clause has nothing to do with liquids and little to do with damages, but it certainly has a way of make things worse when construction projects are not moving smoothly. Here are some tips about the way these clauses are supposed to work and why they are sometimes the contractor's friend.

Liquidated damages clauses are like "binding" estimates of delay damages. In legal-speak, "liquidated" means "fixed". So, a liquidated damages clause can fix the amount which a party must pay when performance is delayed. They usually have language like: "$100 per day for each day of delay", but in rare cases, they are phrased as: "10% of the contract price".

The courts are not supposed to enforce a liquidated damages clause when the amount is intended to punish a contractor by assessing a lot more in damages than a delay might realistically cause. Nevertheless, courts do not want to interfere with the rights of parties to negotiate a contract of their own choosing. So while the law gives the courts the right to throw out a clause if the liquidated damages amount was not a reasonable estimate of likely future delay damages, this rarely occurs. Furthermore, to the extent the actual delay damage amount would be difficult to estimate at the time of contracting, the more likely the clause will be upheld.

When liquidated damages are actually assessed, they are not necessarily for the entire delay period. Typical clauses can only be enforced for the period when the delay starts until the date of substantial completion. If a contract extends liquidated damages to final completion, then a lower liquidated damages rate should be included for that later period. Furthermore, the majority of court decisions will not permit liquidated damages to be assessed unless the contractor is at fault for delay. A few court opinions, however, have extended liquidated damages to time periods when the delay was not the fault of either party.

When a proposed contract includes a liquidated damages clause, consider whether it might actually help the contractor. If the rate in the contract is very small in comparison to the type of project, the clause can limit the contractor's exposure to an amount which is less than actual delay damages. If the Owner insists upon an unfavorable clause, ask whether the Owner prepared a pre-bid estimate of its anticipated loss from delay or obtained a study. Then, get any response in writing. This is helpful during negotiations, and also, any later attempts to attack the amount as not reasonable. In addition, try to clarify that the clause only applies to delay caused by the contractor through the time of substantial completion.

During contract performance, contractors must also protect themselves. If appropriate, request lots of extensions of time, in writing, because contracts usually state that a failure to request an extension can result in a waiver of the defense. At the very least, all requests and any responses become part of the evidence which the contractor can later use if accused of causing delay. Finally, contractors should be careful to any maintain all schedule updates in order to show how any delays were not the contractor's fault.