Construction Law Section Newsletter

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Message From the Editor

by Joseph J. Hocking

The state of the economy continues to adversely impact construction in New Jersey, and we, as construction lawyers, suffer along with our clients. Nevertheless, there are some indications of an improving outlook for construction.

Governor Chris Christie recently announced that the Schools Development Authority will move forward with 10 new school projects valued at $584 million, although 2012 construction is expected on only two of those projects.

Additionally, in a Nov. 3, 2011, blog, Bob Jordan of the *Asbury Park Press* reported that the Alliance for Action, a New Jersey nonprofit group that supports infrastructure investment, projected $26.6 billion in construction over the next two years by public agencies and certain private sectors, an 18 percent increase over the group's prediction last year. Let's hope that projection is accurate.

Our membership has come forward with some great articles for this edition. Thanks to all contributors.

If you have a submission for our next newsletter, please contact me at jjh@spsk.com.

Inside this issue

The Potential Pitfalls of Doing Business with Disadvantaged Business Enterprises Under Federal Law

by Gerard P. Brady and Jared Hand

In 1980, the United States Department of Transportation (DOT) issued regulations in connection with a program designed to increase the participation of minority and disadvantaged business enterprises (DBEs) in federally funded public construction projects. These regulations require state and local transportation agencies that receive federal funds to establish goals for the participation of DBEs. In addition, these state and local agencies are required to ensure that good faith efforts are made by general contractors to employ qualified DBE subcontractors.

While the DBE program was created with the best of intentions, its implementation on state and local levels has led to unforeseen consequences, including the indictment and conviction of numerous general contractors and DBE subcontractors. This article will review and discuss case law regarding general contractors' non-compliance with DBE programs, and propose shifting the risks associated with employing DBEs from the general contractor to the government.

What is a DBE?

A DBE is a small, for-profit business concern that is at least 51 percent owned and controlled by socially and economically disadvantaged individuals. The firm must be independent, and must operate in a self-sufficient manner. Further, the owners must meet the federal definition of "socially and economically disadvantaged" (women, minorities, or individuals who can document their disadvantage; each must also demonstrate that their adjusted personal net worth is no more than $1.32 million). Owners must possess the power and expertise to control the daily operations and management of the firm, and be able to establish at least 51 percent ownership through real and substantial investments of capital. If any one of these conditions is not met, the company will not qualify as a DBE.[1]

The Goals and Requirements of a DBE Program

DBE programs specifically require that state and local transportation agencies, receiving DOT financial assistance, establish goals for the participation of DBEs. The statutes authorizing DBE programs require at least 10 percent of the authorized project funds to be expended with DBEs.[2] The goal for a specific contract may vary depending on factors such as the type of work involved, the location of the work to be performed, and the availability of DBEs in regards to the specific type of work on a particular contract.[3]

In order to participate in DBE programs, a minority and/or female-owned company must be certified as a DBE. Once a business entity is DBE-certified, a general contractor can receive credit toward the attainment of its DBE percentage goals by subcontracting work to that DBE, so long as the DBE performs a "commercially useful function."

Under federal regulations, a DBE performs a commercially useful function when it:

(a) is responsible for the execution of the work under the contract; (b) is carrying out its responsibilities by actually performing, managing and supervising the work involved; and (c) is responsible, with respect to materials and supplies used on the contract, for negotiating price, determining quality and quantity, ordering the material, and installing (where applicable) and paying for the material itself.[4]

A DBE does not perform a commercially useful function if their role is limited to that of an extra participant in a contract, transaction, or project through which funds are passed in order to obtain the appearance of DBE participation.[5]

The goals of DBE programs are to: (1) create a level playing field on which DBEs can fairly compete for DOT-assisted contracts; and (2) assist in the development of firms that can compete successfully in the marketplace outside the DBE program.[6]

Such goals are especially important in the construction industry, because of its insular nature. Without these programs in place, contractors would continue to subcontract portions of their work to business entities with which they already have a successful working relationship. Moreover, the DBE program allows these enterprises to obtain the knowledge and experience necessary to develop their companies into entities that industry professionals feel confident contracting with.

Despite DBE programs creating an environment of fairness for socially and economically disadvantaged businesses, general contractors are often hesitant to enter into subcontracts with DBEs. The most prevalent reason is that many of the available DBE subcontractors are unable to perform their portion of the work in a timely and cost-efficient manner. General contractors who are required to enter into subcontracts with these DBEs are, therefore, subjected to a great deal of risk, including the liability that arises in the case of a defaulting DBE. As a direct result of this risk, some general contractors have resorted to illegal ways of sidestepping the formal DBE requirements, as evidenced by the following two cases.

Case Studies

In *United States v. Tulio*,[7] a construction contractor and his landscaping company were convicted in the United States District Court for the Eastern District of Pennsylvania of mail fraud and conspiracy to commit mail fraud. The defendant, Tulio, submitted bids to the Southeastern Pennsylvania Transportation Authority (SEPTA) to replace storm drain pipes along an existing railroad line. In his bids, Tulio stated and certified that the requisite percentage of work, as required by SEPTA's DBE program, would, in fact, be subcontracted to a DBE. After accepting Tulio's winning bid on two occasions, SEPTA learned that Tulio never used a DBE, but rather used fraudulent business utilization reports, invoices, and proofs of payment to create an appearance of compliance with SEPTA's DBE program. It was further discovered that Tulio agreed to pay a fee to the DBE he purported to be using as compensation for using their name in the false representations made to SEPTA.

In *San Francisco Bay Area Rapid Transit Dist. v. Spencer*,[8] the plaintiff brought suit against the defendant, his companies and their employees, for damages it claims were caused by the defendants' fraudulent practices in connection with work performed under Bay Area Rapid Transit (BART) construction contracts. Here, the defendant owned a non-DBE construction firm and created a joint venture with a DBE construction firm. The defendants' rationale behind forming this joint venture was that the company would be more attractive for prime contractors to subcontract with, since they would be able to receive credit toward their DBE percentage goals.

In *Spencer*, the United States District Court for the Northern District of California determined that the joint venture *did not* qualify as a DBE. The reason behind this finding was that the two companies had merely entered into an agreement by which the non-DBE construction firm would perform all the work while paying the DBE firm for the use of its name and DBE status. The only responsibility the DBE firm had under the agreement was to convince the awarding agency that the joint venture was a legitimate DBE. In return for fulfilling its responsibilities, the DBE firm received kickbacks from the company that was actually performing all the work.

Shifting the Risk of Doing Business with DBE Subcontractors Back to the Government

In order to level the playing field among general contractors bidding on work, and reduce the risk of doing business with DBEs, perhaps the DOT should make the local governmental agency issuing the contract responsible for soliciting bids from and selecting one or more competent DBE subcontractors to perform a defined scope of work as separate prime contractors. The government would then agree to assume the risk in the event that the DBE prime contractor failed to perform. The government could select the appropriate DBE contractors through a separate request for proposal (RFP) or competitive bidding process, and define the scope of work to be performed by the DBE companies in the main prime contract. This type of arrangement would enable the general contractor to focus on what it does best—managing, scheduling and constructing the project—without the worry of trying to increase the participation of competent DBEs in federally funded public construction contracts.

Conclusion

While federally regulated DBE programs strive to, and do achieve laudable goals in many circumstances, there is an ever-present risk associated with doing business with these entities. In order to allow DBE programs to achieve their goals and maximum potential, it may be prudent to start placing the risks associated with doing business with these entities on someone other than the prime contractor. Until then, those entering into subcontracts with DBEs should be extremely vigilant in their business relationships with DBEs, and conduct regular audits to ensure compliance with the applicable DBE program.

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Endnotes

1. 49 C.F.R. § 26.5.
2. This 10 percent requirement holds true "except to the extent the Secretary determines otherwise." 49 C.F.R. § 26.41.
3. 49 C.F.R. § 26.51(e)(2).
4. 49 C.F.R. § 26.55(c)(1).
5. 49 C.F.R. § 26.55(c)(2).
6. 49 C.F.R. § 26.1.
7. 263 Fed. Appx. 258 (3d. Cir. 2008).
8. *San Francisco Bay Area Rapid Transit Dist. v. Spencer*, C 04-04632 SI, 2007 WL 1450350 (N.D. Cal. May 14, 2007).

Some Practical Input to Attorneys Representing Troubled Contractors When Communicating With Their Sureties

by David C. Dreifuss

While, during my more than 30 years of practicing law, I have met many capable and talented construction lawyers, I have found that many of them are either uncertain as to what advice to provide their financially troubled contractor clients relative to communication with the clients' sureties and/or provide advice that they or their clients may ultimately regret. As an attorney who has primarily represented sureties for more than 30 years, this article is intended to provide some practical guidance for those attorneys and their clients. However, I should note that not every surety and/or counsel representing sureties responds or acts in the same manner and, therefore, the recommendations set forth in this article may not apply in all situations and/or to all sureties.

With that *caveat* in mind, here are some suggestions:

Advise Your Clients to Not Wait Until It Is Too Late

Many contractors are afraid to inform their sureties that they are experiencing financial problems. I am not suggesting that a contractor starting to experience financial concerns immediately contact its surety. However, when a contractor cannot meet all of its obligations, with the result that the surety will likely receive notice of claims from subcontractors and/or suppliers, it is generally best to advise the surety, in advance, about what is happening. It may also be wise to schedule a meeting with the surety to discuss how best to address the issues.

Many contractors are afraid to do this because they assume the surety will immediately refrain from issuing additional bonds and/or demand collateral. While that is a possibility, in my experience it is far more likely to happen where the contractor (surety's principal) withholds information and/or provides misleading information until the surety receives numerous claims, than if the contractor approaches the surety, explains the issue and has a reasonable proposal about how to avoid and/or minimize an ultimate loss.

It should also be noted that contractors frequently attempt to defer their problems by paying subcontractors/suppliers who 'make the most noise,' as opposed to paying them as required by statute under the Trust Fund Act.[1] Contractors should be made aware of the fact that violations of the statute, which applies to public funds, result in personal liability, generally are not dischargeable in bankruptcy, and can result in criminal charges being pursued against the contractor and responsible individuals. Further, it frequently does not delay the inevitable for long.

Advise Your Client to Be Honest

The dishonesty that takes place during some initial communications never ceases to amaze me. Sureties, due to their experience over the long run, generally investigate and/or verify the information provided by the contractor. When a contractor advises its surety of financial problems or issues, many sureties are inclined to retain a consultant to investigate the allegations and attempt to determine the extent of the problem. If you have not presented the surety with an honest and accurate picture, the consultants usually easily detect that fact, and will report to the surety that you and your client have attempted to deceive the surety. When this occurs, it results in a lack of trust, leading most sureties to deny assistance to their principals, even where they might otherwise be inclined to help. They also will likely pursue indemnity rights far more aggressively.

One important underwriting factor, as explained to me, is credibility. In my experience, it is also often a critical factor to the surety's claims handlers.

At Least Start With a Willingness to Cooperate

A number of years ago, I attended three meetings in one week with three different contractors on behalf of three different sureties. Yet, the scenarios were all the same. The claims representative from the surety and I walked into the room to meet with the financially troubled contractor and its attorney. After we shook hands and introduced ourselves, each contractor threw his keys on the table and indicated that if the surety wanted his company, it could have it. In all three instances, I explained to the contractor and the attorney that we had anticipated an offer of cooperation to minimize losses, not the approach taken. I also explained to them the significance of the Trust Fund Act and potential violations thereof, as well as the surety's rights pursuant to the indemnity agreement.

I then indicated that the claims representative and I would go for a short walk, and if, when we returned, the keys were still on the table, we would "see the contractor in court." If, on the other hand, the keys were off the table and the contractor was willing to cooperate with the surety in an effort to minimize its losses, we could then at least discuss what the cooperation would consist of and what the surety might be willing to agree to. Fortunately, in all three instances, when we returned the keys were off the table and we worked together to minimize the losses.

In that regard, the contractor generally is far more knowledgeable, at least initially, than the surety about the status of the bonded project or projects; the amounts due subcontractors and suppliers; the extent of the remaining work; which subcontractors have performed well and which have not; and a number of other factors that could be extremely important in connection with minimizing the losses, irrespective of how those losses are ultimately addressed. That disclosure and cooperation will frequently help a surety minimize its losses, and thus its indemnification claim, and may result in a number of benefits to the contractor and individual indemnitors, such as the surety agreeing to a favorable repayment plan and/or some other concessions. In contrast, a lack of cooperation will likely result in the surety being inclined to pursue all of its rights against all indemnitors.

Consider the Surety's Perspective

Many contractors explain how they will benefit if the surety does what they are asking of it. However, they fail to consider the surety's perspective. For example, some contractors have requested financial assistance to enable them to continue to operate, but have not proposed to make any changes, such as laying off their inexperienced but highly compensated relatives or no-show relative employees. Others request financial assistance but expect the company will be able to continue to pay them hundreds of thousands of dollars per year, pay for their rented Mercedes and allow them to continue their luxurious lifestyles.

It is far better to demonstrate to the surety the sacrifices the contractor is prepared to make in exchange for some form of assistance. Also, it can often be critical to propose collateral of some form for the surety's consideration.

Do Your Homework First

It is very disturbing to learn how little some contractors know about their own companies. I once met with a contractor and counsel who presented some fairly persuasive arguments for the surety to lend it approximately $75,000. The next day, the contractor's attorney called and said that it really needed $475,000. Two days later, it was up to $750,000. This demonstrated that the contractor really did not know the company's financial condition, and totally undermined the otherwise fairly persuasive arguments for providing financial assistance to that principal.

It is far better to perform the analysis first and present the surety with accurate numbers and requests. Again, the surety will most likely fully investigate whatever information you provide before rendering a decision, so indicating that your client knows his or her business may help the surety's comfort level.

Likewise, counsel should understand his or her client's and/or the surety's legal obligations. A principal is not an insured. The surety has no obligation to defend or finance the principal. The principal has an obligation, at common law and generally by contract, to indemnify and/or exonerate the surety. If counsel fails to understand this, and attempts to threaten the surety when he or she should really be requesting help, most sureties will respond negatively, and will assume that cooperation will not be forthcoming.

Attempt to Present Alternatives

Presenting alternatives can be important, since some sureties have had negative experiences with one or more of the options potentially available. By presenting alternatives, it demonstrates that the contractor has carefully considered those options, and while it prefers one to the others, it is prepared to fully cooperate with the surety regarding either. Again, offering collateral can also be very important.

Conclusion

Most sureties, when a contractor goes into claim, do not start as the enemy. However, they can quickly become the contractor's worst enemy, since they usually have the right to not just pursue recovery from their principals, but also from the owners of the principals, and frequently their spouses.

While the above may appear to be common sense, my experience indicates that most contractors requesting help understand few, if any, of the above comments/suggestions.

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Endnote

1. N.J.S.A. 2A:44-148.

Equipment and Experience Requirements in Bid Documents Are Generally Material and Non-Waivable

by Adrienne L. Isacoff

Well over a quarter of a century ago, Judge Sylvia Pressler enunciated a two-part test in a Law Division decision that has been relied on ever since to determine whether a bid element was material or minor. The two-prong approach set forth in *Township of River Vale v. R.J. Longo Construction Co., Inc.*,[1] and adopted by the Supreme Court in *Meadowbrook Carting Co., Inc. v. Borough of Island Heights*[2] and numerous other cases, considers the following factors when analyzing the propriety of a waiver of bid requirements:

> [First], whether the effect of waiver would be to deprive the municipality of its assurance that the contract will be entered into, performed and guaranteed according to its specified requirements, and second, whether it is of such a nature that its waiver would adversely affect competitive bidding by placing a bidder in a position of advantage over other bidders or by otherwise undermining the necessary common standard of competition.

Notwithstanding the utility of the *River Vale* test, the Supreme Court noted in *Meadowbrook* that our courts "have been somewhat inconsistent in articulating the difference between a material defect in a bid that cannot be waived and an immaterial defect that can be waived."[3]

Section 23.2 of the Local Public Contracts Law Identifies Mandatory Bid Elements

In an effort to stem the ongoing tide of litigation involving materiality issues, in 1999 the Legislature adopted an amendment to the Local Public Contracts Law (LPCL),[4] which identified certain mandatory bid items, including a bid bond; consent of surety; statement of corporate ownership; listing of subcontractors; and acknowledgment of revisions or addenda.[5] Failure to submit any one of those mandatory items is deemed to be a fatal defect that may not be waived or cured post-bid.

While the amendment deflected a limited group of bid protest actions, bidders, public owners and the courts continue to grapple with the circumstances under which bid requirements that are not statutorily mandated may be waived. Requirements to submit documentation evidencing financial capacity, equipment, facilities and experience present a particularly fertile area for litigation.

The court first explored the limited effect of the amendment in *P & A Construction, Inc. v. Township of Woodbridge*, which dealt with a bidder's failure to submit a certified financial statement.[6] The trial court concluded that since financial statements were not among the items identified in the amendment, the local contracting authority had implicit authorization to waive its submission. The Appellate Division reversed, holding that the requirement in the bid proposal for submission of a certified financial statement was material under the *River Vale* test and, therefore, not waivable by the contracting agency. The court cited *Meadowbrook* ("[t]he Legislature obviously regarded the financial capacity of a bidder to be a material and substantial consideration in the determination of the lowest responsible bidder....")[7] and *Impac, Inc. v. Paterson* (finding that other bidders may have been deterred from submitting a bid because they reasonably believed that they would have to submit a certified audited financial statement).[8]

Two cases decided within the past year have revisited this issue in the context of failure to submit conforming experience, plant and equipment questionnaires. In one appeal, the consolidated actions involving *Vanas Construction Co., Inc. v. City of Jersey City* and *Arco Electrical Contractors, Inc.*, and *Jogi Construction, Inc. v. City of Jersey City*,[9] the Appellate Division affirmed the lower court's conclusion that the experience and plant and equipment questionnaires were material and, therefore, the city abused its discretion in permitting a post-bid cure. In *Johnson Baran Corp. v. Ocean County Board of Freeholders*,[10] the Appellate Division affirmed the trial court's decision that the fact that certain statements made by the low bidder concerning its ownership of a milling machine were erroneous was a waivable defect.

The *Vanas* Case

In the *Vanas* matter, in addition to requiring the general contractor to submit certain evidence of financial capacity and experience, Jersey City also required the submission of a "Certificate of Experience and Questionnaire" to be completed by each of the subcontractors required to be named by the bidder pursuant to N.J.S.A. 40A:11-16 (plumbing, HVAC, electrical and structural steel) in connection with two different projects. The low bidders on each of the projects failed to include a completed certificate for all of their prime trade subcontractors.

Importantly, the Appellate Division agreed with the position of the appellant-bidders that "not every item designated as mandatory in a bid proposal means that the item is material and therefore non-waivable." The Appellate Division further acknowledged that Section 16 of the LPCL includes a puzzling reference. In the case of a single bid contract, the bids must contain the names of the prime trade subcontractors "each of which subcontractors shall be qualified in accordance with P.L. 1971, c.198 (C.40A:11-1 *et seq.*)" As the opinion put it, "[a] review of the LPCL does not set forth any particular requirement for subcontractors other than their listing under Section 11-16." For that reason, the Appellate Division did not agree that the failure to provide the certificate for the subcontractors violated N.J.S.A. 40A:11-23.2, as the trial court found.

Nevertheless, the court found that the city did not act in consonance with the principles of public bidding when it waived its own requirements to be furnished with subcontractor equipment documentation. The court reemphasized that, although the required submissions were not mandated by the amendment, the determination of whether the defects are minor is subject to the *River Vale* test.

First, the opinion pointed to Section 20 of the LPCL, which provides that public owners may require a certificate showing that the bidder owns, leases or controls the necessary equipment required by the plans and specifications. "The inclusion of this provision in the LPCL is clear evidence of the substantive materiality of the Questionnaire here because it calls for the bidder to provide most of the information set forth under Section 11-20."

The court observed that the requirement that a bidder show that it owns or leases the requisite equipment provides assurance to the contracting agency that the bidder will be able to complete performance if it is awarded the contract, citing *P & A Construction*.[11] Of course, that element satisfied one prong of the *River Vale* test of materiality.

With respect to the second prong, the court also found that the "requirement of obtaining Certificates and supporting documents from all subcontractors could lessen the pool of subcontractor candidates from which a bidding contractor can choose...." Waiving that requirement afforded the low bidders an unfair advantage.

Therefore, the Appellate Division concluded that the inclusion of a requirement to furnish equipment certifications on behalf of subcontractors in bid specifications is a material, non-waivable bid element.

The *Johnson Baran* case

In the *Johnson Baran* matter, the bid documents required the submission of a "Plan and Equipment Questionnaire," which, among other things, asked the bidders to identify the equipment available for use on the project, including whether the equipment was owned or leased. It further asked the bidders whether they had made contracts or received firm offers for materials included in their bid estimates. The defendant low bidder answered that it owned a milling machine that would be used on the project. After a protest was lodged by the second bidder, upon being asked to provide proof of ownership of the milling machine the low bidder submitted a form titled "Sales Order Form," dated several days before the bid opening, signed by both the seller and the bidder, with the payment terms calling for a wire transfer prior to shipment of the equipment. The second bidder argued that the document was merely a "sales order," not a complete purchase.

The trial court ruled, and the Appellate Division affirmed, that "[a] bidder with a contract to purchase the milling machine and a bidder with ownership and possession were on [an] equal playing field under the terms of the bid specifications." The opinion noted that the low bidder could not walk away from the job even if the sale fell through, because he could still lease the equipment. Under these circumstances, the erroneous statement of ownership was a non-material deficiency that could be waived and cured post-bid.

Conclusion

Notwithstanding the adoption of the amendment identifying certain mandatory bid elements, the *River Vale* test is alive and well. As applied to evidence of financial wherewithal and related evidence of capacity to undertake and complete the subject project, failure to conform will generally be considered to be a material deficiency.

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Endnotes

1. 127 N.J. Super. 207 (Law Div. 1974).
2. 138 N.J. 307 (1994).
3. *Id*. at 319.
4. N.J.S.A. 40A:11-1 *et seq*.
5. N.J.S.A. 40A:11-23.2.
6. 365 N.J. Super. 164.
7. 138 N.J. at 322.
8. 178 N.J. Super. 195, 202 (App. Div. 1981).
9. 2010 WL 5185088 (N.J. Super. Ct., App. Div., decided Dec. 23, 2010)
10. 2011 WL 2518806 (N.J. Super. Ct., App. Div., decided June 27, 2011)
11. *P & A Construction*, *supra*, 365 N.J. Super. at 173.

Consolidate Residential NUB Arbitrations

by Sean E. Regan

As most construction practitioners are aware, the New Jersey Construction Lien Law[1] was amended effective Jan. 7, 2011. Prior to those amendments being signed into law by the governor, this author was part of an *ad hoc* committee organized by the New Jersey Builders Association to respond to the New Jersey Law Revision Commission's request for comments from the industry. Some of this author's comments about arbitration of residential notices of unpaid balance and right to file lien (NUB) claims were presented to the commission (N.J.S.A. 2A:44A-21 requires filing a pre-lien NUB and demand for arbitration). Some significant changes to the law were even made that address the issues raised.

The revised statutes now have an entirely new provision that states, in part at N.J.S.A. 2A:44A-21b.(3):

> All arbitrations of [NUBs] pertaining to the same residential construction shall be determined by the same arbitrator, whenever possible....

This revision goes a long way toward eliminating the likelihood of inconsistent and contradictory arbitration decisions that existed under the original lien law in multi-family residential construction projects when multiple NUBs were filed.

One example of the resulting conflicting decisions conveyed to the commission related to a 10-story, 100-unit high-rise along the Jersey shore. As the real estate market and sales slowed in 2006, then collapsed through 2008, the project failed. Without getting into economic theory or opinion, it appeared from the facts of the case that the sales price of the units dipped below the aggregate per unit price needed to clear the construction and development loans on the building. The general contractor did not get paid on several payment requests, and filed a NUB for an alleged balance due of $4 million for completed work. The alleged completed work was performed and provided by 13 different subcontractors. Each of the 13 subcontractors also filed a NUB. Thus, there were 14 NUBs filed over the same $4 million potential "lien pool." The lien pool is established by statute.[2]

Previously, N.J.S.A. 2A:44A-21, which still requires the filing of a NUB and mandatory arbitration on "residential construction" projects as a prerequisite to filing a lien, could and did lead to conflicting arbitration decisions. This occurred in the referenced case when the general contractor, and each subcontractor, filed a separate NUB and demand for arbitration.

In a high-rise condominium project there can be two, three, four, or a dozen separate arbitrations over the same lien pool. Before the 2011 amendments, each hearing would have a different arbitrator, and a different decision regarding the owner's right to set-off or a bond pursuant to N.J.S.A. 2A:44A-21b.(5).

N.J.S.A. 2A:44A-21b.(5) states in pertinent part, if the

> amount of any setoffs or counterclaims presented in the arbitration cannot be determined by the arbitrator in a liquidated amount, the arbitrator, as a condition precedent to the filing of the lien claim, shall order the lien claimant to post a bond, letter of credit...or such amount as the arbitrator shall determine to be 110% of the approximate fair and reasonable value of such setoffs or counterclaims...

In the high-rise example discussed here evidence was presented by the owner at the general contractor's NUB arbitration that the work done by the 13 subcontractors had significant defects, and a set-off or bond was required for the owner's counterclaims, pursuant to N.J.S.A. 2A:44A-21b.(5). The arbitrator found approximately $1.5 million of liquidated setoffs and counterclaims, and stated in his award that the general contractor was permitted to file a lien for the amount claimed, less the liquidated counterclaim amount of $1.5 million. Posting of a bond of $1.5 million was not awarded. The setoff was primarily awarded for defective windows, steel erection, and roof installation, which resulted in continuous water leaks and mold problems in the building. Yet, when the window, steel and roof subcontractors' NUBs were each arbitrated separately, the assigned arbitrator did not find in favor of the owner on the same presentation of evidence of defects and leaks.

In each of the 13 subcontractor NUB arbitrations the assigned arbitrator allowed a full lien for the amount claimed due by the subcontractor. With respect to the largest claim—that filed by the window subcontractor—the arbitrator was coincidentally the same one assigned for the general contractor's arbitration. He refused to consolidate the window subcontractor's NUB arbitration with the general contractor's arbitration, and likely had no statutory authority to do so. Further, he allowed the entire window subcontractor's lien.

The arbitrator's reasoning, which this author still believes was flawed, was that the owner's setoff claims were reduced from the general contractor's lien claim. The true effect of the decision coupled with the full lien claims allowed for the steel and roof subcontractors in two separate arbitrations, was to add back on to the property and owner the very $1.5 million the arbitrator had set off against the general contractor, and never require a bond to protect the owner or other lien claimants.

Previously, there were few options to consider in circumstances where there were multiple NUBs filed on multi-family residential construction projects prior to the statutory amendment. The first option was to seek a consent from the general contractor and all subcontractors to engage in one arbitration. This was, however, not likely to occur. The second option was to assert to the arbitration administrator and the arbitrator that N.J.S.A. 2A:44A-21b.(7) required consolidation.

N.J.S.A. 2A:44A-21b.(7), which has not been substantially amended, was the only guidance in this regard, and simply stated that:

> any other contractor, subcontractor or supplier whose interests are affected by the filing of a [NUB] shall be permitted to join in such arbitration; but the arbitrator shall not determine the rights or obligations of any such parties except to the extent those rights or obligations are affected by the lien claimant's [NUB].

This provision was impotent in convincing the arbitration administrator, or the arbitrator to consolidate multiple NUB hearings, as it gave the arbitrator no actual authority to do so.

Now, N.J.S.A. 2A:44A-21b.(3) states, in pertinent part:

> All arbitrations of [NUBs] pertaining to the same residential *construction shall be determined by the same arbitrator, whenever possible*. The claimant, owner, or any other party may also request consolidation in a single arbitration proceeding of the claimant's [NUB] with any other [NUB] not yet arbitrated but lodged for record by a potential lien claimant who name was provided in accordance with section 37 of the P.L. 1993, c. 318 (C.2A:44A-37). The request shall be made in the demand for arbitration or, in the case of a request by a person other than the claimant, by letter to the arbitrator assigned to the arbitration or, if none has been assigned, to the appropriate arbitration administrator, within five days of when the demand for arbitration is served. *The arbitrator shall grant or deny a request for a consolidated arbitration proceeding at the arbitrator's discretion*. (emphasis added.)

N.J.S.A. 2A:44A-21b.(5) was also amended to further require that the arbitrator "shall consider all determinations made by that arbitrator in any earlier arbitration proceeding pertaining to the same residential construction."

The above new statutory provisions can eliminate inconsistent results by having the same arbitrator hear and determine all of the owner's counterclaims for setoffs. More importantly, the amendments give the arbitrator the explicit authority he or she previously lacked to consolidated NUB hearings.

Although the requirements for consolidation of NUB arbitrations are now clearly set forth in the amended statutory language of N.J.S.A. 2A:44A-21b.(3), in certain cases the discretion of the arbitrator to not grant the request for consolidation may not be acceptable. In such cases, court intervention to force the consolidation might be justified. The New Jersey Alternative Dispute Resolution Act lends additional support in this regard at N.J.S.A. 2A:23A-3, and states in pertinent part:

> ...[w]henever the claims to be resolved in an alternative resolution proceeding may involve evidence, witnesses and testimony reasonably necessary to resolve issues and facts arising out of a related project or series of agreements, which are the subject of litigation in any court of this State, the court may authorize consolidation of the alternative resolution proceeding and the court proceedings to advance expeditious use of court time.

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Endnotes

1. N.J.S.A. 2A:44A-1, *et seq.*
2. *See* N.J.S.A. 2A:44A-10 and 2A:44A-21b.(3). *See also*, *AEG Holdings, LLC v. Tri-Gem Builders, Inc.*, 347 N.J. Super. 511, 513 (App. Div. 2002); *Croft v. Stevenson Lumber Yard*, 179 N.J. 56, 68 (2004); and *The Thomas Group v. Wharton Sr. Housing*, 163 N.J. 507, 521 (2000).

Allen v. V & A Bros., Inc.: The Expansive Reach of the Consumer Fraud Act Extends to Company Officers and Employees

by Damian Santomauro

The New Jersey Consumer Fraud Act (CFA)[1] is widely viewed as one of the strongest consumer protection statutes in the United States,[2] and "its history has been marked by the constant expansion of consumer protection."[3] While the 'constant expansion' of the CFA has typically related to consideration of the types of claims that fall within the statute and the nature of the parties that can assert such claims, the New Jersey Supreme Court's recent decision in *Allen v. V & A Bros., Inc.*[4] addressed the issue of who can be held liable under the CFA.

Specifically, the *Allen* decision expands the reach of the CFA to include liability against a contracting business entity's officers and employees for violations of the CFA, including violations of the Home Improvement Practices regulations enacted pursuant to the CFA.[5] As a result, plaintiffs may now seek to impose individual liability directly against officers and employees through the assertion of a CFA claim, without having to attempt to reach the individuals through traditional corporate veil-piercing or alter-ego theories. With respect to construction practitioners, the decision highlights the importance of ensuring that contractors and other parties abide by their obligations under statutes and regulations that can potentially trigger CFA liability, such as the Contractors Registration Act[6] and the Home Improvement Practices regulations.[7]

In *Allen*, the plaintiff homeowners hired V & A Brothers, Inc. to level a portion of their property and build a retaining wall so a separate company could install a pool. The estimated price for the work was approximately $160,000, but the parties did not execute a written contract setting forth the price or the scope of work to be performed by V & A Brothers.[8] Although the plans for the retaining wall required a specific type of backfill to support the wall, an inferior grade was utilized during construction. In addition, V & A Brothers increased the height of the retaining wall by approximately 50 percent from what was shown in the plans.[9]

The plaintiffs paid V & A Brothers in full after its work was completed. At the time, however, V & A Brothers had not obtained the appropriate municipal approvals for the work.[10]

Shortly thereafter, the plaintiffs noticed the pool was tilting in place. The plaintiffs hired an engineer, who determined the retaining wall constructed by V & A Brothers was built too high and unsuitable backfill was used to support it, both of which were causing the wall to move.[11] The plaintiffs then filed a complaint asserting a breach of contract claim against V & A Brothers and a CFA claim against the company, the two owners of the company, and the company's sole employee. The CFA claim asserted that the defendants violated the Home Improvement Practices regulations[12] by failing to execute a written contract, failing to obtain final approval for the construction before accepting final payment, and failing to obtain the plaintiffs' consent before modifying the design of the retaining wall and using inferior backfill.

The trial court dismissed the CFA claims against the individual defendants, but the Appellate Division reversed, holding that the plaintiffs were entitled to pursue claims of CFA liability against the individual defendants.[13]

On appeal, the New Jersey Supreme Court noted that the CFA imposes liability for "[t]he act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation...in connection with the sale or advertisement of any merchandise or real estate, or with the subsequent performance of such person as aforesaid,"[14] and defines "person" to include "any natural person or his legal representative, partnership, corporation, company, trust, business entity or association, and any agent, employee, salesman, partner, officer, director, member, stockholder, associate, trustee or cestuis que trustent thereof."[15] Based on the broad definition of person, and the broad, remedial purpose of the CFA, the Court concluded that any corporate officer or employee who commits an affirmative act or knowing omission that violates the CFA can be held individually liable, even if it is only the business entity that contracted with the plaintiff consumer.[16] In doing so, the Court noted that prior decisions from New Jersey courts reflected that there "is no basis on which to conclude that the [CFA] meant to limit recourse to the corporation, and thereby shield the individual from any liability."[17]

With respect to regulatory violations, which were at issue in *Allen*, the Court acknowledged that the issue of whether to impose CFA liability on a corporate officer or employee is a "complicated question."[18] Specifically, because regulatory violations can create strict liability under the CFA, "notions of fairness" are implicated if the violations can be utilized to impose liability directly on a corporation's officers or employees.[19] Nevertheless, the Court established a framework for determining the circumstances in which it would be appropriate to impose such liability. This framework involves consideration of the specific regulation at issue and a fact-sensitive inquiry that explores the role the individual defendant had in violating that regulation.[20] The Court noted that, in performing such an analysis, principals of a corporation are more likely to be liable under the CFA for regulatory violations than a corporation's employees because the principals are the ones who set the policies that the employees implement.[21] The Court then remanded the case back to the trial court to consider the CFA claims against the individual defendants.[22]

The *Allen* decision broadens the range of potential defendants that can be culpable for CFA claims that arise out of a transaction. Not only can the corporate entity that contracted with the plaintiff consumer (which can be an individual consumer, or in certain instances, a business entity) be held liable under the CFA, but any officers or employees of that company now face potential exposure to such claims. In effect, the Court determined that the CFA's statutory language creates a *de facto* veil-piercing cause of action for CFA violations. Thus, consumers can forego the rigors of pleading and proving a separate veil-piercing/alter-ego cause of action to impose liability on individual defendants by simply pleading a CFA claim against the defendants.[23]

The *Allen* decision is of critical importance to construction practitioners because principals and employees of construction companies now face significant individual exposure to CFA claims. Communications with the consumer regarding construction and disclosures made with respect to construction not only are avenues for the consumer to assert misrepresentation and omissions CFA claims against the construction company, but also expose the individual(s) making the communications and disclosures to CFA liability. Similarly, to the extent that a construction contract implicates the CFA or the regulations enacted thereunder, corporate employees who deal directly with the consumer and corporate officers involved in setting the policy that is complained of will likely be targeted as CFA defendants.

The CFA imposes treble damages and attorneys' fees on parties found liable under the statute. As such, consumers and their attorneys will likely use it as a sword to target individuals associated with a construction company when disputes arise, in the hope that the threat of exposure to the potentially crippling remedies afforded to CFA plaintiffs will result in a resolution favorable to the consumer. Moreover, because the determination of individual liability under the CFA is highly fact-sensitive, courts will likely be reluctant to dispose of these claims at the summary judgment phase,[24] which will significantly increase the costs and risks of CFA litigation to individual defendants.

Because the Court's decision in *Allen* exposes officers and employees of a construction company to CFA liability for their involvement in violations of the CFA or regulations enacted thereunder, construction companies should endeavor to limit the circumstances that potentially create liability and the number of individuals from the company that are involved in these circumstances. It may be prudent to establish policies that specifically identify the individual who will be involved in direct communications with the plaintiff and the circumstances in which direct communications are permitted. Similarly, because principals of the company are more likely to be liable for regulatory violations, it may be appropriate to establish a policy that creates a mechanism for ensuring compliance with applicable statutes and regulations enacted pursuant to the CFA, such as the Contractors Registration Act and the Home Improvement Practices regulations.

Going forward, there will almost certainly be an increase in CFA claims asserted by plaintiffs directly against individual officers and employees of defendant companies.[25] While there is likely nothing that can completely immunize a company's officers and employees from the reach of the CFA, prudent companies and their attorneys should closely scrutinize the practices and policies of the company in an effort to minimize risk and insulate principals and employees from exposure to CFA claims and the time, expense, and potentially significant damages associated with these claims.

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Endnotes

1. N.J.S.A. § 56:8-1, *et seq.*
2. *In re Philips/Magnavox TV Litig.*, 2010 U.S. Dist. LEXIS 91343, *26 (D.N.J. Sept. 1, 2010) ("New Jersey's CFA is by all accounts 'one of the strongest consumer protection laws in the nation'") (*quoting Cox v. Sears Roebuck & Co.*, 138 N.J. 2, 14-15 (1994)).
3. *Czar, Inc. v. Heath*, 198 N.J. 195, 201 (2009) (internal quotation marks and citations omitted).
4. 208 N.J. 114 (2011).
5. *Id.*
6. N.J.S.A. § 56:8-136, *et seq.*
7. N.J.A.C. § 13:45A-16.1, *et seq.*
8. *Allen*, 208 N.J. at 118.
9. *Id.* at 119-20.
10. *Id.* at 121.
11. *Id.* at 121.
12. *See* N.J.A.C. § 13:45A-16.2(a)(12); N.J.A.C. § 13:45A-16.2(a)(10)(ii); N.J.A.C. § 13:45A-16.2(a)(3)(iv).
13. *Allen*, 208 N.J. at 121-22.
14. *Id.* at 128 (*quoting* N.J.S.A. § 56:8-2).
15. *Id.* (*quoting* N.J.S.A. § 56:8-1(d)).
16. *Id.* at 131.
17. *Id.* at 131-32 (*citing Gennari v. Weichert Co. Realtors*, 148 N.J. 582, 608-10 (1997); *New Mea Constr. Corp. v. Harper*, 203 N.J. Super. 486, 502 (App. Div. 1985); *Hyland v. Aquarian Age 2000, Inc.*, 148 N.J. Super. 186, 193 (Ch. Div. 1977); *Kugler v. Koscot Interplanetary, Inc.*, 120 N.J. Super. 216, 251-57 (Ch. Div. 1972)).
18. *Allen*, 208 N.J. at 133.
19. *Id.*
20. *Id.* at 133-34.
21. *Id.* at 134.
22. *Id.* at 136.
23. *Id.* at 133 ("Although one might engage in an alternative veil-piercing approach, nothing in the CFA or the relevant precedents suggests that in the absence of veil-piercing the individual employee or officer will be shielded from liability for the CFA violations he or she committed").
24. *Id.* at 135 ("These necessarily fact-sensitive determinations often will not lend themselves to adjudication on a record presented in the form of a summary judgment motion.").
25. *See, e.g., Kort v. Van Aswegen*, 2011 N.J. Super. Unpub. LEXIS 2746 (App. Div. Nov. 1, 2011).

What is the Length of Prohibition for Offending Contributions Under Chapter 51/Executive Order 117?

by Thomas S. Cosma and Mitchell W. Taraschi

New Jersey companies are routinely bombarded by solicitations to make a variety of political campaign contributions. Suppose a business contributes to a candidate's gubernatorial campaign committee, or a state political party committee, or a municipal political party committee, or a committee to re-elect a state legislator? What if the contribution exceeded $300, and was actually made by a check drawn on the account of the company's president or majority shareholder? Probably without even realizing it, the person who wrote that check just precluded the company from entering into a contract with the state or its agencies for a period of time. But for how long?

The practice pejoratively coined as 'pay-to-play' refers to the receipt of government contracts or other favors in return for campaign contributions, or as the result of improper influence-peddling. New Jersey's pay-to-play laws can have a dramatic impact on a business attempting to perform public work. The political contribution may be perfectly proper and legal, in terms of its amount and disclosure under campaign contribution laws.

Regardless of the campaign contribution's propriety, standing by itself, if the contribution is made prior to the award of a state contract, the company may be disqualified from receiving that contract. The prohibition applies even if the contract was publicly bid in a fair and open process, without the taint of political favoritism. Where no pre-bid contribution was made before the contract was awarded, the business entity becomes prohibited from making certain contributions during the contract's term. As a result, a business entity must be aware that its political contributions (as well as those of certain officers, principals, and others whose contributions are attributed to it under the "business entity" definition) may jeopardize its ability to obtain and perform public work.

Different pay-to-play restrictions apply to contracts at the state, legislative, county, and municipal levels of government.

The current scheme began when Governor James E. McGreevey issued Executive Order 134, on Sept. 22, 2004. It prohibited state departments, agencies and authorities from entering into contracts exceeding $17,500 with individuals or entities that made certain political contributions. Executive Order 134 was superseded by Public Law 2005, c. 51, which was signed into law on March 22, 2005, (Chapter 51) and became effective Jan. 1, 2006.

On Sept. 24, 2008, Governor Jon S. Corzine issued Executive Order No. 117 (E.O. 117), which extended the definition of "business entity" to include officers, partners, principals, members and any person who owns or controls 10 percent or more of the entity, as well as the spouse or civil union partner and any resident child (excluding a spouse or child who is entitled to vote for the candidate or resides within the party committee's jurisdiction). E.O. 117 added to the provisions of Chapter 51. The executive orders and the legislation itself contain additional restrictions and reporting requirements that necessitate a thorough review of their provisions.

New Jersey's relevant statute, N.J.S. 19:44A-20.14 is a model of obfuscation, and has caused considerable confusion in its application. It provides that a business entity and its associated principals are ruled off state contracts exceeding $17,500 for making prohibited contributions to recipients covered as follows:

A. Where the contribution is made to a candidate committee or election fund of any candidate or holder of the office of Governor, Lt. Governor, or any State or county political party committee within the 18 months immediately preceding the commencement of pre-contract negotiations for the contract. [N.J.S. 19:44A-20.14(i)]. Public bids are not "negotiated"; they are submitted under seal, publicly opened and read, and a contract eventually awarded. But the assumption is that the date of bid opening is the equivalent date for purposes of the 18 month prohibition.

B. Where, during a Governor's term of office, the contribution is made:
   1. to that incumbent Governor's candidate committee; or
   2. to that incumbent Lt. Governor's candidate committee (assuming it's made after Nov. 14, 2008); or
   3. to a state, county or municipal political party committee or legislative leadership committee (assuming made after Nov. 14, 2008) of the party which nominated the incumbent Governor in the previous Gubernatorial election. In this instance, the prohibition extends for the duration of the incumbent Governor's term of office. [N.J.S. 19:44A-20.14(ii)]

C. Where, during the immediately preceding eighteen (18) months of the last day of the current Governor's term of office, the contribution is made:
   1. to that incumbent Governor's candidate committee; or
   2. to that incumbent Lt. Governor's candidate committee (assuming it's made after Nov. 14, 2008); or
   3. to a state, county or municipal political party committee or legislative leadership committee (assuming made after Nov. 14, 2008) of the party which nominated the incumbent Governor in the last gubernatorial election preceding the commencement of the second term. Here, the business is disqualified not just for the balance of the last 18 months of the incumbent Governor's term, but for the *entire* following 4 years of the second term should that Governor be re-elected [N.J.S. 19:44A-20.14(iii)]

In other words, where the contribution is made prior to an election to a non-incumbent governor, the entity making the contribution is prohibited from bidding on state contracts for 18 months under N.J.S. 19:44A-20.14(i). The other two instances referenced in N.J.S. 19:44A-20.14 (ii and iii) involve contributions made to a sitting governor, including contributions made during the last 18 months of the governor's term.

However, New Jersey's Division of Purchase and Property (DPP) has interpreted N.J.S. 19:44A-20.14 (ii) to prohibit a contribution during the term of *any* governor or lt. governor, rather than the term of office of the incumbent governor or lt. governor. For example, where a reportable contribution was made to "Chris Christie for Governor" during the previous gubernatorial campaign (*i.e.*, during the Corzine administration) but more than 18 months prior to the submission of the bid for the state contract, the DPP ruled that the contribution continued to prohibit the award because it was made during the term of office of "a Governor."

The DPP's interpretation finds no support in either the statute or its legislative history. The Senate State Government Committee's statement to Assembly Bill No. 1500, dated Nov. 15, 2004, stated:

> Under this bill, no State agency, including an independent authority, can enter into a contract of any type with a business entity when the value of the contract exceeds $17,500 if that business entity has made any contribution to a candidate for or the holder of the office of Governor or to any State or county political party committee of a political party nominating *that Governor*: 1) within 18 months before the start of negotiations for the contract; 2) during the term of *the Governor*; or 3) within 18 months before the last day of the Governor's term and through the next term of *that Governor*. (Emphasis added)

Similarly, Acting Governor Richard Codey's conditional veto message to Assembly Bill No. 1500 read:

> Under this bill, no State agency or independent State authority would be permitted to enter into a contract of any type with a business entity, when the value of the contract exceeds $17,500, if that business entity has made any contribution to either a candidate committee or election fund of any candidate for the office of Governor, or to any State or county political party committee under the following circumstances: 1) within 18 months immediately preceding the start of negotiations for the contract; 2) during the term of the Governor

> in the case of contributions for that office; or 3) within 18 months before the last day of *the Governor's term* and through the next term of *that Governor*. (Emphasis added)

In short, a contribution made during any governor's term is not prohibited; it must be a contribution made during the term of office of the incumbent governor in order to be prohibited under N.J.S. 19:44A-20.14(ii). This also assumes, of course, that the contribution is outside the 18-month window from the date of submission of bids or negotiation of contract time frame.

While N.J.S. 19:44A-20.14(i) obviously includes contributions to losing candidates during the 18-month look-back period, N.J.S. 19:44A-20.14 (ii) and (iii) limit the covered period to contributions made "during the term of office of" the incumbent governor or lt. governor, and does not ascribe contributions made during just any governor's or lt. governor's term to the incumbent governor's or lt. governor's term. To the extent that the DPP 'tacks on' to the 18-month period the subsequent term of the incumbent governor or lt. governor, the authors feel it violates the spirit and intent of P.L. 2005, Ch. 51, as evidenced by the legislative history. It is clear that contributions are to be viewed in three separate windows of time under N.J.S. 19:44A-20.14, with three distinct periods of ineligibility.

The authors understand that the DPP, which is charged by the Treasury Department with the administration of Chapter 51 and the review of the "Vendor Certification and Disclosure of Political Contributions Form" required of all state contract submissions, is currently reviewing its interpretation of New Jersey's pay-to-play laws. It appears that if the DPP does not alter its position, many contractors will be improperly disqualified from being awarded public contracts and continued legal challenges to the DPP's interpretation can be expected. ■

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Case Note

School Board's Rejection of Contractor's Bid as Materially Defective Because of Inadvertent Inclusion of Surety's Good-Guy Letter Reversed by Court

by Joseph J. Hocking

Dobco Inc. v. Woodbridge Township Board of Education and Tru-Val Electrical Corporation, MID-L-6268-11 (Law Div. Dec. 2, 2011)

A written affirmation by a surety that it regularly provides bonding to a contractor and is likely to provide bonding for a specific need or contract subject to certain conditions, generally the principal's ability to satisfy the surety's underwriting criteria at the time the bid bond and consent of surety are requested, is commonly referred to in the industry as a "good-guy" letter. The only published decision in New Jersey involving a good-guy letter is *DeSapio Construction, Inc. v. Township of Clinton and Scozzari Builders, Inc.*[1] Plaintiff *DeSapio* was the low bidder, and submitted with its bid only a letter from its surety that stated it "would not anticipate any difficulty providing bonds on the above-captioned project, subject to execution of a contract satisfactory to [the plaintiff and surety]." After bids were opened, DeSapio submitted a supplemental letter from its surety that certified the surety would provide the performance bonds to DeSapio "subject only to execution of the contract." Clinton Township rejected DeSapio's low bid as materially defective, because of the surety's conditional commitments to provide the required performance bonds.

The Law Division upheld the owner's rejection of DeSapio's bid as materially defective, since the bid did not include a consent of surety as required by N.J.S.A. 40A:11-22. Additionally, the Law Division held that the defect in DeSapio's bid was material under the two-prong test established in *Township of River Vale v. R.J. Longo Constr. Co.*,[3] and later adopted by the Supreme Court in *Meadowbrook Carting Company v. Borough of Island Heights*.[4] DeSapio's surety's letters provided the public owner with no assurance that the contract would be fulfilled because no guaranty existed when DeSapio's bid was opened that its surety would provide the performance bond for the duration of the contract. The Law Division further determined that the lack of a binding, unconditional commitment by DeSapio's surety gave DeSapio an advantage over other bidders (*i.e.*, it could avoid its obligation to accept the bid by not obtaining the performance bonds).

Recently, in *Dobco Inc. v. Woodbridge Township Board of Education and Tru-Val Electrical Corporation*, the Law Division held that the inadvertent inclusion of a good-guy letter (intended for a proposal on another project) did not render defective a bid bond, consent of surety and power of attorney ("surety documents"), that were otherwise fully compliant with the bid and statutory requirements. The bid documents included forms prescribed by the board for the bid bond and consent of surety, and the consent of surety form included the following admonition:

> Note: The Consent Of Surety Must Be Unconditional. Riders Or Similar Revisions Or Addenda That Impose Additional Conditions On The Consent Or Bonds Issued Pursuant To It Will Be Cause For Rejection Of The Bid.

After rejecting the low bid for this multi-school solar panel project, the board rejected Dobco's second-low $6,250,000 bid and awarded the contract to the third-lowest bidder, at an additional cost of $233,000. The board determined that Dobco's bid should be rejected because the good-guy letter "conditioning the issuance of the bond to a future underwriting determination results in a failure to submit an unconditional guarantee to provide a performance and payment bond....and renders Dobco's bid materially deficient because it fails to assure the Board that the contract will be entered into and performed in accordance with its terms."

The Law Division reversed, and directed that the contract be awarded to Dobco, finding that Dobco's bid was not defective in any respect. The court noted that the good-guy letter was dated six days before the surety documents, the good-guy letter and the surety documents did not cross-reference each other, and the good-guy letter did not mention the subject contract or bid. Additionally, the court noted, and all parties agreed, that but for the inadvertent inclusion of the good-guy letter, Dobco's bid and its surety documents were fully compliant with the bid requirements. The consent of surety was set forth on the form prescribed by the board, was unconditional on its face, and was accompanied by a properly executed power of attorney.

The court determined that the board's decision to reject Dobco's bid as materially defective was not entitled to deference under an abuse of discretion standard because materiality of an alleged bid defect is a legal issue subject to *de novo* review. Alternatively, the court held that if an abuse of discretion standard applied, the rejection of Dobco's bid was arbitrary and capricious because the good-guy letter did not impair or undermine the unconditional guarantee provided by the consent of surety. Thus, the court held that Dobco's bid satisfied all tenets of the public bidding process, and that failure to overlook the good-guy letter would thwart the goals of the public bidding process and needlessly cost $233,000 more for a mere clerical error of over-inclusion.

The court's decision is on appeal. ■

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Endnotes

1. 276 N.J. Super. 216 (Law Div. 1994).
2. 276 N.J. Super. at 219.
3. 127 N.J. Super. 207 (Law Div. 1974).
4. 138 N.J. 307 (1994).