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IN THIS ISSUE:

NEW CONSTRUCTION

CALIFORNIA SUPREME COURT TO DECIDE WHETHER SECOND-LOWEST BIDDERS MAY SUE LOWEST BIDDER FOR INTENTIONAL INTERFERENCE WITH PROSPECTIVE ECONOMIC ADVANTAGE

The Supreme Court of California recently granted a petition to review a California Court of Appeal decision holding that the second-lowest bidders for public works contracts can state a claim against the lowest bidder for intentional interference with prospective economic advantage. Because the court of appeal's holding rests on bedrock common law principles, the supreme court's ultimate ruling will be of national interest.

The key issue decided by the court of appeal in *Roy Allan Slurry Seal, Inc. v. American Asphalt South, Inc.*[1] was whether the second-lowest bidder for a competitively bid public works contract has a sufficient economic relationship with the awarding authority to support a claim against the lowest bidder for intentional interference. The court of appeal held that, as alleged in the plaintiffs' complaints, the second-lowest bidder had legally protectable interests in the award of the contracts in question.

In *Roy Allan Slurry Seal*, the plaintiffs, two paving contractors, sued a competitor for intentional interference with prospective economic advantage on the grounds that the competitor was able to underbid the plaintiffs on 23 public works contracts by paying its workers less than the statutorily required prevailing wage.[2] Specifically, the plaintiffs alleged that the plaintiffs' and defendant's material costs for each of the projects were essentially the same and that the only substantial difference in their bids came from the defendant's unlawfully low labor costs. The plaintiffs further alleged that, but for the defendant's unlawful conduct, they would have been awarded the contracts for the projects.

The defendant demurred to the plaintiffs' complaints in each of the five counties, the trial courts issued conflicting rulings, and the California Supreme Court coordinated the five cases for appellate purposes and for trial.

The court of appeal held that, as a matter of law, a second-place bidder on a public works contract can state a claim against the lowest bidder for intentional interference with prospective economic advantage sufficient to overcome a challenge at the pleadings stage if the second-place bidder alleges that the winner was only able to submit the lowest bid by illegally paying its workers less than the prevailing wage. In particular, the court of appeal held that the allegation by the second-place bidder that it would have otherwise been awarded the contract is sufficient to satisfy the requirement that there exists an economic relationship with some third party that makes it reasonably probable the plaintiff (here, the second-lowest bidder) will gain some future economic benefit.

In reaching its ruling, the court of appeal relied heavily on the California Supreme Court's opinion in *Korea Supply Company v. Lockheed Martin Corporation*.[3] In *Korea Supply*, the supreme court held that the agent of the losing bidder for a contract to supply military radar to the government of South Korea could state a claim for intentional interference with prospective economic advantage where the agent alleged that the winning bidder obtained the contract by providing bribes and sexual favors to key Korean officials in violation of the federal Foreign Corrupt Practices Act. In reaching its ruling in the *Korea Supply* case, the supreme court held that when the lowest bidder's action is independently wrongful (e.g., illegal), the second-lowest bidder need not allege that the lowest bidder specifically intended to interfere with the second-lowest bidder's opportunity – the general intent to engage in the wrongful conduct is enough.

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[1] 234 Cal. App. 4th 748 (2015)(Review granted at 2015 Cal. Lexis 4179).

[2] Like many states, California has adopted a "mini-Davis-Bacon Act" requiring the payment of statutorily specified wages and fringe benefit contributions on public works projects. California's prevailing wage law appears at Cal. Labor Code § 1720 *et seq.*

[3] 29 Cal. 4th 1134 (2003).

The California Supreme Court granted review in *Roy Allan Slurry Seal* to consider the following issues: "(1) In the context of competitive bidding on a public works contract, may the second lowest bidder state a claim for intentional interference with prospective economic advantage against the winning bidder based on an allegation that the winning bidder did not fully comply with California's prevailing wage law after the contract was awarded? (2) To state a cause of action for intentional interference with prospective economic advantage, must the plaintiff allege that it had a preexisting economic relationship with a third party with probable future benefit that preceded or existed separately from defendant's interference, or is it sufficient for the plaintiff to allege that its economic expectancy arose at the time the public agency awarded the contract to the low bidder?"[4]

The supreme court in *Roy Allan Slurry Seal* granted the petition for review on June 10, 2015, and extended the deadline for the defendants to file their opening briefs to August 10, 2015. The average time from grant of review to decision in the California Supreme Court is about two years.

Bidders for government contracts at the federal, state, and local levels should keep a close watch on the outcome of this case because if the court of appeal's decision is upheld, it will provide an avenue for disappointed bidders to seek common law tort relief directly from the recipients of government contracts.

UNDER CONSTRUCTION

STATUTE OF REPOSE BEGINS TO RUN ON SUBSTANTIAL COMPLETION

In *State v. Perini Corp*., the state of New Jersey brought suit against Perini (the design-build general contractor), the architect, the principal contractor for HVAC, and a pipe manufacturer. New Jersey contracted with Perini to design and build South Woods State Prison, a 3,176-bed medium- and minimum-security correctional facility, in Bridgeton at a cost of approximately $203 million. The project was to be executed in three phases, and after each phase, inmates would occupy the respective completed facility. Phase I was completed on May 16, 1997, and inmates began to utilize those facilities soon thereafter. The certificate of substantial completion for the project, however, was not issued until May 1, 1998.

In relevant part, the design called for hot water to flow through a series of underground pipes, heated by boilers and heat exchangers, that would service the entire project through one unified system. This system, referred to as the HTHW system, ultimately began to fail. A separate certificate of substantial completion was not issued for the HTHW system.

On April 28, 2008, the state filed a complaint alleging that the HTHW system failed in 2000 and on several subsequent occasions. The state alleged that since the first failure in March 2000, there were 10 HTHW carrier pipe failures, including failures involving both supply and return lines as well as the valves.

The defendants moved for summary judgment, arguing that the project was substantially completed well before April 28, 1998, and therefore the 10-year statute of repose under New Jersey law barred the state's action. The trial court granted summary judgment in favor of all defendants but one, finding that because inmates began occupying the facility on or before April 28, 1998, the HTHW system was substantially complete before April 28, 1998. The court, however, denied summary judgment for the pipe manufacturer, holding that because it was a manufacturer of goods, the statute of repose did not apply to it.

The appellate division reversed, finding that although the statute of repose can have separate trigger dates, unless the components of a project qualify as discrete "improvements to real property," the court will interpret the trigger date to be the date of substantial completion for the entire project.

The New Jersey Supreme Court affirmed the decision of the appellate division. Notably, the court held that because the defendants were involved in the overall project following the completion of Phase I, and because the defendants had ongoing responsibilities for the entire project, a separate trigger date for the HTHW system was not supported. Additionally, the court explained that because the HTHW system was designed to support the entire project, it could only be said to be completed once it was connected to every building it was designed to serve.

As a practical matter, if the state law allows for separate trigger dates for the statute of repose, parties should contemplate contractually specifying whether each phase qualifies as a separate improvement for purposes of the statute of repose. Owners obviously have a strong disincentive to this approach as it could become unwieldy and cumbersome to have multiple statutory deadlines. Depending on the complexity of the project and sophistication of the parties, however, it may be a valid topic of negotiation for subcontractors and tradesmen looking to reduce exposure and liability for portions of a project that were completed outside the traditional statute of repose timeframe.

State v. Perini Corp., 113 A.3d 1199, 221 N.J. 412 (2015)

[4] *See* California Supreme Court Docket for case no. S225398 at http://appellatecases.courtinfo.ca.gov/search.cfm?dist=0.

FORGO EXPERTS AT YOUR OWN PERIL

A recent ruling by the United States District Court for the Southern District of Florida is a good reminder that experts are not only useful in construction litigation, they are often required. This is true even if the dispute concerns the breach of a materials contract, as opposed to a dispute over the actual construction or design of a large-scale, complex project.

Plaintiff Thermoset Corp. was hired to install a roof system at an international airport in Nassau, Bahamas. Thermoset purchased roofing materials for the project from defendants Building Materials Corp. of America and Roofing Supply Group Orlando LLC. Shortly after Thermoset installed the roof system, portions of the roof's outer membrane became detached. Consequently, Thermoset was forced to repair and replace large portions of the roof at significant cost.

Thermoset filed suit against the suppliers, alleging a variety of warranty and tort claims on the basis that the suppliers' products were defective or otherwise failed to perform in accordance with various warranties. Thermoset did not present any expert testimony in support of its claims. At the close of discovery, the suppliers filed a motion for summary judgment on all claims arguing that Thermoset's failure to present expert testimony was fatal to each claim. Specifically, the suppliers argued that the issue of whether the roofing material was defective and the issue of whether the roofing material caused the alleged damages were both too complex to be decided by a jury without the aid of expert testimony. The court agreed and granted the suppliers' motion for summary judgment on all claims.

The court explained that although expert testimony is not necessary if "jurors are as capable of understanding and drawing correct conclusions from the facts as an expert witness," expert testimony is necessary when "the technical and scientific aspects of the case would result in the jury's inability to comprehend the issues." In this case, the court believed that the issues (whether the reformulation of an adhesive product adversely affected performance of the product and whether use of the adhesive product after its expiration date caused the alleged damages) were sufficiently complex to require expert testimony.

The court held that a determination of whether the product was defective, and if so, whether the product caused the alleged damages, required substantial technical and scientific knowledge that an average lay juror would not have. Thus, it was Thermoset's obligation to "bridge these gaps in the jury's understanding with expert testimony." The court explained that by not offering expert testimony, Thermoset "is as a matter of law without the tools to lead the jury to the conclusion that its harms resulted from defects" in the roofing materials.

While there is no bright-line rule for determining when expert testimony must be produced, it is always best to offer expert testimony if an average juror could not reasonably infer a fact essential to a party's claim or defense without assistance from an expert.

Thermoset Corp. f/k/a Thermoset Roofing Corp. v. Building Materials Corp. of America et al., Case No. 14-60268-CIV-Cohn/Seltzer, Document 166 (S.D. Fla. April 9, 2015)

WORDS MEAN THINGS: THE POWER OF DEFINITIONS IN CONSTRUCTION CONTRACTS

A recent case in the Federal Circuit revealed the danger of leaving undefined terms in construction contracts.

The Department of Veterans Affairs (VA) awarded a contract to Reliable Contracting Group, LLC, for design and construction improvements to a new medical center. The contract required Reliable to install three backup generators. Notably, the contract required the generators, and all other equipment under the contract, to be "new." While a separate provision of the contract defined "new" under FAR 52.211-5, the provision relating to the generators did not provide a definition. The failure to define this one, small word led to the dispute in this case.

Reliable subcontracted with a separate company to obtain the generators, and that company then contracted with another subcontractor to ensure their procurement. When the generators arrived, however, the VA immediately noted that they were not "new" as required under the contract, and instead showed "a lot of wear and tear including field burns." The VA asked Reliable to certify that the generators were new before installing them. Instead, Reliable, as well as its subcontractors, all agreed in writing that the generators were in poor condition and failed to meet the contract specifications. However, Reliable later determined that, despite their poor conditions, the generators had never been used. The VA still rejected the generators, and ultimately the subcontractors procured and installed different, mutually acceptable generators.

Reliable later submitted a claim to the VA, and subsequently to the Civilian Board of Contract Appeals (CBCA), seeking approximately $1.1 million for the additional costs it incurred following the VA's rejection of the original generators. The CBCA rejected Reliable's claim, finding that the generators were not capable of being factory tested as required under the definition of "new" provided elsewhere in the contract. Reliable appealed, claiming that the proper interpretation of the word "new" was "unused."

The Federal Circuit rejected both definitions. The court determined that the CBCA's definition was improper because the VA never argued that the basis of the generator's nonconformance was their lack of factory testing, and the contract lacked an express requirement of such testing. The court found Reliable's interpretation to be similarly insufficient because it was incomplete. Rejecting the idea that the opposite of "new" is "used," the court determined that the contract provided no single plain meaning of the word "new" in the contract, and that the word was therefore ambiguous. Consequently, the court turned to a variety of dictionaries to conclude that "new" was properly understood to mean both unused and "free of significant damage."

Based on this definition, the court remanded the case back to the CBCA for a determination of the extent of the damage of the generators. Notably, while Reliable and its subcontractors had unequivocally admitted that the generators were significantly damaged, the court found that these admissions provided probative evidence that the generators did not comply with the contract, but they were not binding for judicial purposes.

This case demonstrates the importance of clearly defining every term in a construction contract, especially those terms that relate to requirements for workmanship and material, and the importance of using that same definition throughout the contract to prevent claims of ambiguity. As a result of its failure to do both, the VA is now vulnerable to a claim worth over $1 million. Contractors should make sure to carefully read and define all the terms in each construction contract and consult with their attorneys if anything is unclear. Words have power, especially in the context of a construction contract, and no contractor or subcontractor should leave the interpretation of those words to a dictionary.

Reliable Contracting Grp., LLC v. Dep't. of Veterans Affairs, 779 F.3d 1329 (Fed. Cir. 2015)

OTHER CONSTRUCTIVE THOUGHTS

On August 12, 2015, Chris Roux will present at the Managing Engineering Risk and Ethics Issues seminar at The Courtyard by Marriott Irvine/Orange County in Irvine, CA.

On September 10, 2015, Chris Roux will join a panel to present at a seminar titled "Bid Protests – The 'Need to Know' for the Owner, Selected Bidder and Protestor" at The Grand Conference Center in Long Beach, CA, in connection with the Construction Management Association of America – Southern California Chapter.

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