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Bid Disputes

CONSTITUTIONALITY OF THE AUTOMATIC STAY PROVISIONS OF THE COMPETITION IN CONTRACTING ACT OF 1984

The Competition in Contracting Act of 1984 was enacted as part of Title 7 of the Deficit Reduction Act of 1984, Pub L No 98-369, 98 Stat 494, 1200-03 (codified at 31 USCA §§3553-56 (West Supp 1988)) ("CICA). CICA includes, at 31 USCA 53553, provisions automatically staying the procurement process upon a federal agency's receipt of notice of a bid protest to the Comptroller General. The stay applies preaward. and to awarded contracts, if the agency receives notice of a protest within 10 days of award. The agency may override the stay, upon a written finding by the head of the procuring activity that urgent and compelling circumstances significantly affecting the interests of the United States will not permit waiting for the decision of the Comptroller General on the protest or, in the case of a post-award stay, that performance of the mntract is in the best interests of the United States.

The CICA stay provisions were aimed at preventing federal agencies from effectively defeating bid protests by immediate award. This practice required a disappointed bidder to either seek immediate injunctive relief or risk being left with recovery of its bid preparation costs as its sole remedy.

The CICA stay provisions grant a protestor the equivalent of a preliminary injunction upon filing a protest. The Government would seem to have a fairly heavy burden to lift the stay. These CICA provisions replace the more liberal preexisting Federal Acquisition Regulations ("FAR) §14.407-8(b) (4) (iii), which allowed an agency to award a contract notwithstanding a protest, if it found that it was "advantageous to the government" to do so. Under FAR §14.407-8(c), agencies were merely encouraged to suspend performance if the contract already had been awarded.

Since their enactment, the constitutionality for the CICA stay provisions has been questioned. See Eldon H. Crowell & David T. Ralston, Jr., The New *Government* Contracts Bid Protest Law, 15 Pub Cont LJ 177 (1985). The constitutional issue arises out of the authority granted to the Comptroller General to affect the procurement processes of executive agencies by extending or shortening the stay. The Executive Branch contends that the Comptroller is an agent of Congress and that the powers granted to him by CICA are analogous to the one house legislative veto struck down as unconstitutional in I.N.S. *v. Chadha*, 462 US 919, 103 S Ct 2764, 77 L Ed2d 317 (1983). More recently, arguably analogous Comptroller general powers to mandate budget cuts under the Gramm-Rudman-Hollings Act were held to violate the constitutional separation of powers in Bowsher *v.* Synar, 478 US 714, 106 S Ct 3181, 92 L Ed2d 583 (1986). The Supreme Court found it unconstitutional for Congress to grant executive budget. cutting powers to the Comptroller General, who it held is an officer of the Legislative Branch.

The constitutionality of the CICA stay provisions will likely be determined in the near future. On March 21, 1988, the Supreme Court granted certiorari on this issue in ***U.S.*** *Army* Corps of Engineers *v. Ameron, Inc.* ***US 108 S Ct 1218.99*** L *Ed2d* ***419 (1988).***

The case below was Ameron, *Inc. v. U.S.* Army *Corps of* Engineers. 607 F Supp 962, summary judgment granted, 610 F Supp 750 (D NJ 1985), *aff'd as modified*, 787 F2d 875, *aff'd* as modified, 809 F2d 979 (3d Cir 1986).

In Ameron. the low bidder on a pipecleaning project sought injunctive relief to stop performance of the contract by the second low bidder, relying on the automatic stay provision of the then newly enacted Competition in Contracting Act. The Executive Branch, through its Office of Management and Budget by a memorandum from David Stockman, directed executive agencies not to comply with the CICA stay provisions, which it contended were unconstitutional.

Ameron's bid was rejected by the Corps as non-responsive, because the penal sum of the bid bond had been typed over a white typing correction. The District Court granted a TRO and later a preliminary injunction, holding the CICA stay provisions constitutional. The court held that Congress could delegate the non-legislative power to lift the automatic stay to the Comptroller General, because he is appointed by the President and is not merely an agent of Congress. 607 F Supp at 973. The Comptroller General subsequently denied Ameron's protest and, in further proceedings, the District Court reaffumed its holding regarding the constitutionality of the CICA stay provisions. 610 F Supp at 757. The Third Circuit initially identified as the key issue the characterization of the Comptroller General as an agent of either the Legislative or Executive Branch. The court found the Comptroller General to be part of a "headless fourth branch" of government, with mixed legislative and executive duties not fully within and to a certain extent independent of either branch. In reaching its decision upholding their constitutionality, the court noted that the stay provisions do not provide an ultimate veto over executive action, but are only a tool to avoid the faits accomplis of award during the pendency of a protest. The court also emphasized the statutory override procedure available to the contracting agency. 787 F2d at 887.

Upon rehearing, following the Supreme Court's decision striking down provisions of the Gramm-Rudman-Hollings Act in Bowsher *v.* Synar, supra, the Third Circuit was forced to recast its decision in light of Bowsher's holding that the Comptroller General is an agent of the Legislative Branch. The court again held that the CICA stay provisions do not unconstitutionally authorize the Comptroller General to interfere in executive functions. The court further found that any potential for interference

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is minimal and is outweighed by Congress's substantial interests in competitive procurement and that the stay provisions effectuate, rather than disrupt, the balance of power between the branches. 809 F2d at 997-99.

This issue is far from settled. The revamped Third Circuit opinion seems to have lost some of its impact by backing away from the initial rationale of the majority and abandoning the alternate rationale of the concurring opinion in the first Ameron decision.

Ameron has also become a classic confrontation between the Executive and Judicial Branches, by virtue of both courts' testy reactions to the Reagan Administration's presumption of the power to determine what is unconstitutional. Of course, the courts have regarded determination of "what the law is" to be their province since *Marbury v. Madison*, 5 US (1 Cranch) 137, 177, 2 L Ed 60 (1803). Both courts were further irritated by the intimation by Attorney General Edwin Meese, in a letter to the New York Times and in congressional testimony, that the courts might lack jurisdiction to determine the constitutional issues involved in the case. 610 F Supp at 755-56; 787 F2d at 88990; 809 F2d at 991-92. The Executive Branch did not rescind its noncompliance order until "the House Judiciary Committee approved legislation which would have eliminated all funding for the office of the Attorney General until the Administration agreed to obey the district court's order in this case." 809 F2d at 991-92, n 8; see also Gov't Cont Rep (CCH) No 749 (June 14, 1985).

John F. Bradach

Court Holds That No Specific Findings Are Necessary For Use Of Request For Proposal Contracting Method

Judge Alan Bonebrake of the Washington County Circuit Court has ruled that Washington County's use of a Request for Proposal ("RFP") method for obtaining a contractor for its new public service building was proper and that the county complied with the requirements of ORS 279 concerning exemptions to the competitively bid contracts. Hays, et al. *v. Kane,* Civil No. 87-0869C (Wash. Co. Cir. Ct., October 1987). The County's action was approved by the Court even though the County admitted that it did not make any findings under ORS 279.015(2) regarding the use of the RFP process for either this contract or for the County's contracts in general. Furthermore, from the evidence presented to the Court, it appears that the contract entered into by the County was solely for the construction of the project, whereas the initial RFP was for the development, design and construction of the public service building.

In 1984 the Washington County Board of Commissioners established itself as the County's Local Contract Review Board pursuant to ORS 279.055. Subsequently, in June 1985, the Board adopted the uniform rules governing public contracts for State agencies, which had been promulgated by the Director of the Department of General Services, as its own local rules governing public contracting procedure. ORS 279.015(2) provides that the Director of the Department of General Services or the Local Contract Review Board may exempt certain public contracts or classes of public contracts from the requirment of ORS 279.015(1) that all public contracts shall be competitively bid, upon the following findings:

"(a) It is unlikely that such exemption will encourage favoritism in the awarding of public contracts or substantially diminish competiton for public

"(b) The awarding of public contracts pursuant to the' exemption will result in substantial cost savings to the public contracting agency. In making such finding, the director or board may consider the type, cost, amount of the contract, number of persons available to bid and such other factors as may be deemed appropriate."

The rules prepared by the Director provide, in OAR 125-310025, that public contract agencies may, at their discretion, use RFP competitive procurement methods subject to four conditions concerning information which must be provided in the RFP. OAR 125-300-001 defines a Request for Proposal as "the solicitation of competitive proposals, or offers, to be used as a basis for making an acquisition, or entering into a contract when specification and price will not necessarily be the predominant award criteria." The remainder of OAR 125-300-001 discusses specific types or classes of contracts which are exempted from the competitive bidding requirements.

In 1985, Washington County undertook an analysis of its present and future needs for office space for County staff. Reports generated for the County by outside wnsultants disclosed that the County should try and consolidate its services "under one roof" and should also make adequate provision for its future space needs. An accounting firm retained by the County strongly suggested that the County finance the project hy means other than general obligation bonds and that the County request proposals from developers who would build an office building and then lease it to the County. The accounting firm's report stressed the financial benefits which would accrue to the County if an outside developer financed and, at least initially, owned the project.

Consequently, the County decided to request proposals from developer-architect-contractor teams for construction of the project. The initial step in the RFP process used by the County was to request statements of qualification and interest from developers. The Request for Qualification focused almost entirely on the financial capabilities of the

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developer and discussed only in very vague terms the requirements regarding the design and construction of the project. Of the seven developers who responded to the Request for Qualification, the County selected three developer-architect-contractor teams based primarily on financial capabilities and development experience. The County then requested proposals from the three finalist teams. Each team responded to the RFP with a specific design and with financing information. From the proposals, the County determined to select the one submitted by Haertl, Wolff, Parker, Inc./Howard S. Wright ("Haertl/Wright").

After the selection of the Haertl/Wright proposal, but prior to the County entering into a contract with Haertl/Wright, changes to the Federal tax law, as well as concerns regarding the constitutionality of the proposed financing methods for the project, caused the County to discontinue its plan to have Haertl/Wright finance the project. The County instead elected to own the building itself and finance the construction of the project through general obligation bonds. While the County did not have the authority to issue the necessary bond, and had to await a public vote, it did negotiate contract terms and a price with Haertl/Wright and, in February 1987. in an effort to avoid delay to construction, entered into a contract with Haertl/Wright for the development of specific design documents for the project.

In August 1987, Washington County voters approved the bonds needed to finance the project. Prior to actually signing its contract with Haertl/Wright, however, the County, apparently due to concerns regarding legality of its actions, petitioned the Court pursuant to ORS 33.710 and 33.720 for a judicial determination and judgment as to the regularity and legality of the authorization and validity of the proposed construction contract with Haertl/Wright. While all residents of Washington County were allowed to respond to the County's petition, only one resident timely responded. The resident asked that the Court not allow Washington County to enter into a contract with Haertl/Wright, alleging that the County had violated ORS 279.015 in not making any findings of fact regarding the exemption of the public service building contract from the competitive bidding requirements. The resident also alleged that ORS 279.015(2), which provided for the exemption of certain "contracts or classes of contracts," cannot be used to develop a blanket exemption for any contract issued pursuant to a RFP. Rather, the resident contended that the contract resulting from the RFP process must itself either be exempted or within an exempted class. Finally, the resident also claimed that the construction contract for which the County was seeking approval could have been competitively bid because the development aspect of the original RFP had been abandoned by the County and the design documents had already been prepared pursuant to another contract with Haertl/Wright. Consequently, the resident argued that there was no basis or reason for exempting the specific contract before the Court from the competitive bidding requirements.

The County admitted that it did not make any findings regarding the exemption of the public service building contract from the competitive bidding requirements nor did it make any general findings when it adopted the Director's uniform rules which recognize the use of the RFP process. Rather, the County argued that the findings required by ORS 279.015(2) were made at the time the Department of General Services adopted the Director's rules. The County contended that, by adopting the Director's rules itself, it also impliedly adopted the Director's findings.

The Court held that the construction contract with Haertl/Wright was exempt from formal competitive bidding as a public contract pursuant to a Request for Proposal under OAR 125-300-010 and 125-310-025. The Court ordered and decreed its approval of and confirmation of the regularity, legality and correctness of the Board's actions in approving the construction contract with Haertl/Wright. The matter is presently on appeal before the Court of Appeals.

The County's actions and the Court's decision should be compared to the decision of the Oregon Court of Appeals in Morse Bros. Prestress, Inc. *v.* City *of* Lake *Oswego,* 55 Or App 886 (1982), in which the Court implied that the findings required by ORS 279.015(2) are necessary before an exemption can be granted for a particular contract. The Morse court stated that the findings can be made by the Local Public Contract Board in its resolution adopting the uniform rules of the Director of the Department of General Services. The Court further stated that the public agency in Morse had in fact included such findings in its resolution adopting the rules and therefore had complied with ORS 279.015(2). There has been no contention in Hays *v.* Kane that the County's 1985 resolution adopting the Director's rules had included language sufficient to constitute the required findings under ORS 279.015(2).

Rodney R. Mills

Bid Protests in Oregon After Pen-Nor II

Winston Churchill once described the Soviet Union as "a riddle wrapped in an enigma." The same could be said of the law of bid protest in Oregon prior to the case of *Pen-Nor, Inc. v.* Oregon *State* Dept. *of* Higher Education. 87 Or App 305, 742 P2d 643 (1987) (Pen-Nor II). The Pen-Nor *II* decision has not eliminated all the confusion surrounding bid protests in State contracts but it has dispelled a good

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deal of confusion on the issues of standing, the nature of suite, the nature of the remedy and the timeliness of an action. While Pen-Nor Inc. was a disappointed potential subcontractor to a prime contractor, the principles announced in the case are applicable to all protestants. The case has no application to contracts let by local public bodies. Those are governed by ORS 279.067.

Bid protests are of two general types, protests against specifications and protests of award. Protests as to the nature and form of the specifications are governed by OAR 13730050. Failure to file an exception to the specification in writing prior to the time set for receipt of bids waives the protest, In the case of public improvement contracts the protest must be filcd ten days prior to the date set for receipt of bids. For other contracts, the protest must be filed five days before the date set for receipt of bids. Failure to file within the time allowed waives any protest of an award based upon the specification. OAR 137-30-050.

In the Pen-Nor case the protestant had no quarrel with the specification. It claimed that the award was flawed due to the contracting officer's alleged failure to enforce statutory requirements in making the award. Neither the rules in OAR Chapter 137 Division 30 nor the statutes in ORS Chapter 279 speak directly to this kind of a protest on State public contract. Under prior law a variety of approaches had been explored. These included suits for injunction based upon "tax payer status", Gruber *u.* Lincoln Hosp. *Dist.*, 285 OR3, 588 P2d 12431(1979); suits to restrain ultra vires acts awarding contracts, *Hanson u.* Mosser, 247 Orl, 427 P2d 97 (1967); and a writ of mandamus Strand Century. Inc. *u. Dallas,* 68 Or App 705, 683 P2d 561 (1984). None of the approaches proved to be entirely or consistently satisfactory. Varying requirements for venue, standing and time of filing created a bewildering procedural maze. This may have led counsel for Pen-Nor Inc., Mr. Charles Merten. to file two cases. One case filed in the Court of Appeals challenged the State's decision to award the contract as an "order in a contested case." Pen-Nor, *Inc. u.* Oregon Dept. *of* Higher Education, 84 Or App 502,734 P2d 395 (1987) (Pen-Nor I). The other case filed in Multnomah County Circuit Court brought a variety of claims, including one for review of the decision as an "order in other than a contested case." Pen-Nor, *Inc. u.* Oregon Dept. *of* Higher Education, 87 *Or* App 305, 742 P2d 643 (1987) (Pen-Nor II).

The Court of Appeals rejected the theory that an award was an order in a contested case under case under ORS 183.480 and ORS 183.482 and dismissed the appeal in *Pen-*Norl. The court also found that the award was not a "rule" to be reviewed under ORS 183.400. So ended Pen-Nor I.

The posture of the case in Pen-Nor *II* was somewhat different. There the circuit court had dismissed plaintiffs complaint for lack of standing and plaintiff appealed to the Court of Appeals. Pen-Noirll, 87 Or App at 307. On appeal the court held that plaintiff could not maintain a declaratory judgment action against the State, but did have standing to question the agency's action under the non-contested case provisions of the APA. *Id.*, 309. It is this decision that deserves further exploration.

In Pen-Nor *II* the Court of Appeals did not elaborate on why the subcontractor's claim was reviewable under the APA. However, the court's decision comports with the plain reading of the Act.

Generally speaking, the Oregon Administrative Procedures Act divides all state agency action into two distinct categories. The first, as highlighted in Pen-Nor I. compromises those actions that the state may undertake only after a formal administrative hearing is held. These are known as "contested case" hearings under the Act. ORS 183.310(2) (a) (A), when the agency has discretion to revoke a right or privilege, ORS 183.310(.) (a) (B), or when it suspends or refuses to renew a license. ORS 183.310(2) (a) (C). None of these situations was present in Pen-Nor I. No statute required a formal hearing, the asgency was not revoking a right or privilege and no license suspension was involved.

Despite the fact that no formal hearing was required, the agency's action in awarding a contract to the prime contractor and the implicit finding that the prime had made "good faith efforts" to satisfy the MBE requirements of ORS 279.059 does meet the definition of an agency "order" as defined in ORS 183.310(5) (a):

> "'Order' means any agency action expressed orally or in writing directed to a named person or named persons. . .

Whether or not the order is "final" depends upon whether or not the order is in writing, and whether or not the decision of the agency is simply preliminary. ORS 183.310(5) (b). However, an order is not preliminary simply because the agency retains discretion to review that decision at a later date. Land *Reclamation u.* DEQ, 292 Or 104, 106,636 P2d 933 (1981).

The fact that the agency's decision to accept the prime's bid as a "final order" was apparently too obvious a proposition for the court to discuss. Clearly the contract between the State and the Prime or the notification to the prime that it was low bidder, constituted a "final order" because it was in writing directed to a named person describing agency action.

The determination that agency action is governed by the APA should affect the time and manner by which a party seeks judicial review.

The judicial review provisions of the APA are contained in ORS 183.480. That statute provides, in part:

> "(2) Judicial review of final orders of agencies shall be solely as provided by ORS 183.482, 183.484, 183.490 and 183.500.

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> (3) ***No action or suit shall be maintained*** as to the validity of any agency order ***except a final order as provided in this section*** and ORS 183.482, 183.484, 184.490 and 183.500, or except upon showing that the agency is proceeding without probable cause, or that the party will suffer substantial and irreparable harm if interlocutory relief is not granted." (Emphasis added.)

This statute's predecessor was interpreted in ***Bay River v. Environmental Quality Commission,*** 26 Or App 717, 554 P2d 620 (1976) to mean that the APA was the sole means by which agency decisions could be challenged. In ***Bay River,*** plaintiff had sought declaratory relief and had obtained an injunction requiring the agency to provide the petitioner with subsurface sewer disposal permits. ***Id.,*** 719. Upon appeal, the court held that neither an injunction nor a declaratory judgment was authorized because the circuit court had lacked jurisdiction to entertain those actions. ***Id.,*** 723.

The court first noted that the APA provides the exclusive method for challenging agency actions, citing *School Dist. No. 48 v. Fair Dism. App. Bd.,* 14 Or App 35, 512 P2d 799 (1973). The court then rejected Bay River's attempt at equitable relief outside the APA:

> "This sufficient answer to Bay River's contention that since it couched its complaint in equitable terms and sought a declaratory judgment, the circuit court obtained jurisdiction pursuant to ORS 28.010. ***A party cannot ignore the judicial review provisions of the APA in favor of a general equitable or declaratory remedy." Id.,*** 720. (Emphasis added.)

The court then vacated the injunction and all decrees issued by the circuit court. ***Id.,*** 723.

In ***Bay River,*** the court concluded that plaintiff should have proceeded to a contested case hearing. *Id.,* 721. Yet the exact nature of the remedy under the APA does not alter the exclusive nature of its judicial review provisions. For example, in ***Dinsdale v. Young,*** 72 Or App 778, 697 P2d 200 (1985) the plaintiff sought a writ of mandamus to compel state agency action. The court held that the circuit court had no jurisdiction to hear the matter because the APA was the exclusive judicial remedy. ***Id.,*** 779. In a footnote in a later case, the court noted that the plaintiff in ***Dinsdale had*** failed to seek review under the non-contested case provisions of the APA. ORS 183.484. ***Mongelli v. Oregon Life and Health Guaranty,*** 85 Or App 518, 522 n.4, 737 P2d 633 (1987).

Mongelli was yet another case in which a plaintiff was directed to the judicial review provisions of the APA. In that case the court held that plaintiff could not obtain a writ of mandamus, but held that it could proceed upon its allegations under the APA./ ***Id.***. 520 These ***cases*** make clear that the failure to file a petition seeking review under the APA when challenging agency action could result in dismissal of a complaint seeking simply injunctive or declaratory relief. Because petitions for review of non-contested case orders must be filed within 60 days of the date the order is served, ORS 183.484(2), a party may find that it has missed the applicable statute of limitations for contesting the agency's decision to award a contract to another person or entity.

Although ***Pen-Nor II's*** decision focused on a subcontractor who had not made a bid directly to the State, no different decision should be obtained if it is the bidder who challenges the agency's action. For example, if the state agency was to reject the bidder's bid, that action would clearly fit the definition of an "order" under ORS 183.310(5).

In a typical bidding sitvation the rejected bidder may not receive any document in writing from the State indicating that its bid has been rejected. However, this fact alone will probably not stop the 60 day time period from running under ORS 183.484(2). The "final order" by which the rejected bidder is "aggrieved" under ORS 183.480 need not be directed toward the rejected bidder, only to a "named person or named persons." That final order may well be the contract itself, since that represents agency action expressed in writing. ORS 183.310(5) (b). Moreover, the order is effective if the rejected bidder has personal knowledge of the order despite never having received it in person. ORS 183.330(2).

Nor should counsel assume that the contract is the only document which constitutes a "final order." First, there is nothing in the APA that suggests that the agency cannot issue more than one final order about a particular matter. Therefore, if the rejected bidder receives written notitication of the rejection prior to the contract being awarded, prudent counsel will immediately challenge that determination under the APA. Althought the decision to whom the contract is to be awarded may not be final. the decision to reject that particular bidder may be final.

Such a result was obtained in the unreported case of *NAS v. State of Oregon,* before the Marion County Circuit Court. In that case, Judge Miller held that a rejected bidder that had received written notification of bid rejection prior to the award of a contract had received a "final order" for purposes of the 60-day statute of limitation under ORS 183.484(2). Because that bidder had waited until after the contract was awarded, the statute of limitations was missed and a directed verdict was entered after the close of plaintiffs case-in-chief.

Moreover, in ***NAS.*** the written notification of rejection did not arrive by formal letter from the agency. Instead the facts of that case showed that the bidder had traveled to Salem after learning verbally of a rejection of its bid. Upon amval. the bidder had received a tabulation sheet of all bidders which indicated that the bidder's bid had been

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rejected. Judge Miller held that this was sufficient to constitute a "final order" for purposes of the APA.

In conclusion. the ***Pen-Nor*** decisions represent a significant advance in the Oregon law of bid protests as it applies to State contracts. ORS 183.400 and ORS 183.484 lay out clear and uniform requirements as to standing venue, timeliness, remedies and standard of review. Would that the Federal system were so simple!

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Note. The opinions expressed in this article are those of the author and do not necessarily represent the official position of the Department of Justice.

Editor's Note: The authors' suggested scope of the ***Poi-Nor II*** holding may be beyond the express holding of the case. Query: Would the result have been same had the State Board of Higher Education not conceded that the award constitutes an ***APA*** order? ***Pen-Nor II***, on its face. may apply only post-award on State contracts. Further, the implication that APA review may be had on a whole range of State public contracting issues must be considered in the context of the court's ruling in S.J. ***Groves*** and ***Sons Company v. The State of Oregon.*** Multnomah County Circuit Court No. 86-09-05551. In that case, Judge Pro Tem Pullen denied the State's Rule **31** Motion asserting that exclusive jurisdiction over Grove's claim for damages on an ODOT contract was in the Court of Appeals, pursuant to ORS 123.480 and ORS 183.482. The approach of the AG's office to these **issues** warrants careful consideration by a practitioner handling cases adverse to the State. Consideration should be given to alternative pleading of a right to APA review or parallel filings seeking APA remedies in bid disputes and, perhaps, in other proceedings relating to State contracting.

Richard E. Alexander

Note: The opinions expressed in this editor's note are those of the editor and do not necessarily represent the opinions of the editorial committee or the Construction Law Section.

Competing Claims In Construction Contractor Bankruptcies

A general contractor secures financing for a building project by pledging its assets and the contract proceeds as security. A financial institution lends money to the contractor based upon that security. The financial institution is generally comfortable with its position and assumes that is has the primary security interest in all the general contractor's pledged assets. However, the financial institution's position may be compromised by a contractor's miscalculation of a bid, incompetence, labor problems, bad weather, or any bit of ill fortune. If a general contractor runs into real problems, it may end up in bankruptcy court, where the lending institution will not be the only interested creditor.

When the contractor cannot complete the project it has begun, the surety company which bonded the job may be called upon to perform the contract. If the surety provided a payment bond as well as a performance bond, the surety may also have to pay the claims of subcontractors and material suppliers the general contractor failed to pay. Even if the job was not bonded, other parties besides the financing institution will have an interest in the case. Typically, the owner will have retained a certain percentage of the contract balance. This retainage will vary from case to case, depending upon the parties' contract and the amount of work the contractor has completed. Of course, the owner will have an interest in the retainage, as will any surety who has paid to complete the work or satisfy subcontractor and material supplier claims. If the general contractor has not paid its income, withholding, or Social Security taxes, the Internal Revenue Service may attempt to assert a tax lien against the retainage. Finally, the bankrupt contractor's representative, the trustee in bankruptcy, will attempt to protect the interests of the debtor, as well as the interests of other creditors of the contractor. These competing interests are the subject of this article.

THE SURETY'S SUBROGATION RIGHTS

When a contractor is in default, its surety will be called upon to complete the work and pay the subcontractors and material suppliers. **A** surety who completes a contract or pays the subcontractors will claim entitlement to any contract balance retained by the owner under its equitable right of subrogation. In 1896, the United States Supreme Court recognized the surety's rights in the fund retained by the owner of a project in ***Prairie State National Bank v. United States,*** 164 US 227, 17 S Ct 142, 41 L Ed 412 (1896).

At issue in ***Prairie State*** was the retainage withheld by

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the United States on a contract to erect a customhouse. When the general contractor defaulted, the surety stepped in and completed the work. After completion, the surety sought to recover the retainage. The contractor, however, had assigned its rights in the contract balance to Prairie State National Bank. The bank had made interim advances to the contractor to fund construction. The surety issued the bond in 1888, when the contract was signed. The Supreme Court held that the contractor's assignment, two years later, of its rights in the contract balance did not affect the surety's prior equitable right of subrogation to the owner's (the United States) rights against the retainage given the contractor's failure to perform.

"(The contractor) could not transfer to the bank any greater rights in the fund than they themselves possessed. Their rights were subordinate to those of the United States and the sureties." 164 US at 240, 17 S Ct at 147, 41 L Ed at 419.

Twelve years later, the United States Supreme Court further extended the surety's equitable right of subrogation when it held that a surety which had paid subcontractors' or suppliers' claims on a payment bond had first priority to the contract balance. Hennignsen *v. United States* Fidelity & G. Co., 208 US 404, 52 L Ed 547 (1908). In more recent times, the Supreme Court has characterized the surety's right of subrogation as follows:

"(P)robably there are few doctrines better established than that a surety who pays the debt of another is entitled to all the rights of the person he paid to enforce his right to be reimbursed. *** It seems rather plain that at least two prior decisions of this Court have held that there is a security interest in a withheld fund like this to which the surety is subrogated *** " *Pearlman u.* Reliance Ins. *Co.*, 371 US 132, 136-137, 83 S Ct 232, 235, 9 L Ed 2d 190, 193 (1962).

The courts have also held that the surety's equitable right of subrogation is not limited to Miller Act cases; it applies to bonded, private construction jobs as well. Framingham Trust Co. *v. Gould-National* Batteries, *Inc.*, 427 F2d 856, 858 (1st Cir 1970). This priority also extends to cases in which the surety pays previously unpaid subcontractors and material suppliers. See also *In* Re *J.V.* Gleason Co., 452 F2d 1219 (8th Cir 1971); *First Ala. Bank v.* Hartford *Acc.* and *I.* Co., 430 F Supp 907 (ND Ala 1977); *McAtee u.* United States Fidelity and Guaranty *Co.*, 401 F Supp 111 (ND Fla 1975).

CREDITOR'S RIGHTS TO UNPAID PROGRESS PAYMENTS

In the cases discussed above, the surety end the lending institution both sought to recover the unearned and unpaid portion of the contract balance retained by the owner; the surety prevailed. Courts have also held that the surety also has priority over the contractor's lender in cases involving earned but unpaid progress payments. National Shawmut Bk. *of Boston v.* New Amsterdam *Cas. Co.*, 411 F2d 843, 848 (1st Cir 1969). See also American Fire *& Cas.* Co. *u.* First *Nat.* Bank *of* New York, 411 F2d 755 (1st Cir 1969). In the latter case, 21 progress payments had been earned by the contractor, but only 16 had been paid. Those 16 had been paid to the assignee bank. Thereafter, the contractor defaulted and the surety was called upon to perform its obligations under the bond. The First Circuit held that the surety was entitled to the five progress payments earned by the contractor before its default; the bank was entitled to retain the 16 progress payments which it received before the contractor defaulted. The court in Shawmut also held that, absent circumstances amounting to fraud, the surety cannot divest the contractor's assignee of progress payments earned and paid before default. 411 F2d at 848. However, the reverse is also true — the bank cannot prevent the surety from recovering any progress payments which might have been earned but unpaid prior to the contractor's default.

"But for the surety's completion of the work, the obligee on the bond, be he owner or prime contractor, would have been entitled to apply the funds against the cost of completion. It is the surety's performance which frees the funds, and, in our view, the surety is entitled to them." American Fire & Casualty Co., 411 F2d at 758.

ARTICLE 9 VS. THE SURETY'S "SECRET" LIEN

Prairie State National Bank is the first in a line of cases in which the courts held that, under the common law, the surety's equitable right of subrogation was superior to the bank's interest in the contract balance. Despite protestations of lenders and other secured creditors that the surety's position constituted a secret lien, enactment of Article 9 of the Uniform Commercial Code has not changed the court's view of equitable subrogation. Courts deciding the issue have held that a surety's equitable right of subrogation takes priority over the bank's Article 9 security interest.

Because the surety's claim on the contract balance is not based on a security interest, Article 9 of the UCC does not apply. National Shawmut Bk. *of* Boston *v.* New Amsterdam Cas. Co., 411 F2d at 845-846; see generally J. White and R. Summers, Uniform Commercial Code 888889 (1980). The First Circuit in *Shawmut* held that the surety's interest in the contract balance arose not as a security interest, but rather from the inherent status of the surety. 411 F2d at 846. The court also took note of the rejection by the drafters of the Uniform Commercial Code of a provision which would have subordinated a surety's interest to that of a lender which perfected its security interest.

One rationale for the conclusion that a surety's position

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does not constitute a "secret" lien is that persons who lend to contractors are almost always aware of the presence of a surety which is guaranteeing the contractor's obligations under the contract. White and Summers, supra, at 889.

DOES "FIRST IN TIME" MEAN "FIRST IN RIGHT?

Particularly galling to lenders is the idea that they could be "first in time" and still not have a priority over the surety. However, the courts have not agreed with a "first in time, first in right" argument and have concluded that the interests of the surety and the lending bank arise simultaneously. See ***First Ala. Bank v. Hartford Acc. & I.*** Co., 430 F Supp 907, 911 (ND Ala 1977); ***Finance*** Co. ***of America v. U.S. Fid. & Guar.*** Co., 277 Md 177, 353 A2d 249, 254 (1976). The courts reason that when a contractor assigns to a bank its rights to the proceeds of a construction contract, the contractor is assigning only those rights to payment which exist when the assignment is made. ***First Alabama Bank.*** 411 F Supp at 911. No right to payment exists until the contractor has a valid contract with the owner. Id. The procurement of a bond by the contractor is often one prerequisite to a valid contract with the owner; this is usually the case on public projects where bonds are required by statute. On such projects, there is no contract and no right to payment until the contractor is bonded. Therefore, the bank's interest in the contract proceeds arises only when the surety agrees to bond the project.

A surety may not always he able to defeat a bank's prior perfected security interest. A bank's interest and a surety's interest may not arise simultaneously in a case where the surety's interest arose after the bank perfected its security interest. Where statutes or the contract itself do not prevent it, the contractor may enter into a valid contract with the owner before the surety issues its bond. In such a case, the contractor might be able to make an assignment, because it would have a choate right to payment. If the assignment were made before the surety bonded the job, the bank would defeat the surety. However, lenders realize that on all but the smallest of jobs, a bond is a prerequisite to a valid contract.

Also, the surety will not succeed in defeating a bank's prior perfected security interest if the surety collects progress payments before the contractor is in default. *First Alabama Bank of Birmingham,* 430 F Supp at 911. So long as the contractor is not in default, the contractor, or those to whom he has assigned his rights in the contract balance, are entitled to the progress payments made by the owner.

So long as the surety has no obligation to begin performance under its bond, it has no rights *to* contract payments as a subrogee. *Fidelity and* Deposit Co. *of Md. v. Scott* ***Brothers Const. Co.,*** 461 F2d 640 (5th Cir 1972). In ***Scott Brothers.*** a surety contested an assignee bank's right to a progress payment received before the contractor sent formal notice of its default to its surety. The surety contended that the contractor's formal notice of default merely acknowledged a situation that already existed in fact, as the surety had been concerned about the contractor's financial condition for some time. The Fifth Circuit held that until the contractor either stated that it could no longer continue on the job or materially failed in its performance, the contractor could not be considered in default, and therefore, the surety had no right to progress payments. ***Scott Brothers.*** 461 F2d at 643. See also ***Kane v. First Nat. Bank of El Paso, Tex.***, 56 F2d 534 (5th Cir 1932).

TAX LIENS ON RETAINAGE: BANKS AND SURETIES **VS.** THE IRS

Financially troubled contractors, like other insolvent employers, may neglect to fulfill their obligations to Uncle Sam. The government generally takes a dim view of such practices. The Internal Revenue Service may assert a tax lien against the unpaid contract balance when the contractor has failed to pay withholding, Social Security, or income taxes.

A surety may have priority over the government where the government files a tax lien on retainage. IRC §6323 allows a surety priority over the government's tax lien when certain conditions are fulfilled. First, the surety must have a security interest as defined in the code (§6323(1)). (This "security interest" is ***not*** the same as a UCC security interest.) Second, the security interest must be in "qualified property" (§6323(c)(4)(C)(i)). Third, the contract between the surety and the contractor must have been entered into before the tax lien was filed (§6323(c)(1)). Fourth, the security interest must constitute an "obligatory disbursement agreement" (§6323(c)(1)(A)(iii)). Fifth, the security interest must be protected under local law against a judgment lien arising out of an unsecured obligation (§6323(c)(1)(B)). The surety does not have priority over the tax lien unless the surety has parted with "money or money's worth" (i.e., made a payment on its bond). ***State of Ohio v. City of Greenfield, Ohio,*** 528 F Supp 955, 959 (SD Ohio 1981).

Examples of the operation of the tax lien statutes are contained in the IRS regulations. See Regs §301.6323(c)-3; §301.6323(a)-1. These regulations also provide that a security interest with priority over a tax lien will have its priority extended to the extent under local law that certain items have the same priority as the security interest. These items include interest on the obligation secured, attorney fees, and other charges. Regs §301.6323(e)-1.

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BANK VS. IRS

The bank vs. surety competition was discussed above. The bank generally fares better against the IRS, since IRC §6323 also applies to a bank's prior perfected security interest. *Kimberly-Clark* Corp. v. Alpha *Bldg. Co.*, 591 F Supp 198 (ND Miss 1984). Subsection (a) of §6323 provides that:

"The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary."

The security interest mentioned by the statute is defined as any interest in property acquired for the purpose of securing payment; the interest in question also must be protected under local law against a subsequent judgment lien arising out of an unsecured obligation. IRC §6323(h). The court in *Kimberly-Clark* held that (1) a bank's prior perfected security interest in contract proceeds met the definition of a security interest under IRC §6323(h) and (2) "(i)t is clear that a tax lien does not prevail against a prior perfected lien." 591 F Supp at 206, citing Aetna *Ins.* Co. v. Texas *Thermal Industries, Inc.*, 591 F2d 1035, 1038 (5th Cir 1979); see also *S. D'Antoni*, Inc. v. Great Atlantic & *Pacific* Tea Co., *Inc.*, 496 F2d 1378 (5th Cir 1974).

Thus, while a bank with a prior perfected security interest may be able to prevail against a surety only under certain circumstances, a bank which is "first in time" as against the IRS will be "first in right" as well.

THE OWNER'S OFFSET RIGHTS

The surety and the bank may both be subject to the government's common-law rights of offset on public works projects. Despite the fact that the bank and the surety may defeat government's tax lien under IRC §6323, the government may assert its common-law right to offset. Sentry Insurance v. United States, 12 Ct Cl 320 (1987). In Sentry Insurance, the claims court held that when a payment bond surety pays subcontractors on Miller Act projects, the surety's equitable right of subrogation does not entitle the surety to recover all of the retainage held by the government. Id at 322. A surety may be subrogated to the contractor's rights, but if the government, through its right to offset, has a right to the retainage superior to that of the contractor, the government's right is superior to that of the surety who is subrogated to the contractor's rights. Id. See also United States Fidelity and *Guar.* Co. v. United States, 201 Ct Cl 1,475 F2d 1377 (1973); Home Indemnity Company v. United States, 313 F Supp 212 (D Mo 1970).

POSTPETITION ADVANCES BY THE LENDING INSTITUTION

Lending institutions sometimes are called upon to advance funds to a contractor after the contractor has filed a petition for bankruptcy. See generally Rosenberg and King, Collier Lending Institutions and the Bankruptcy Code, 4.04 (Bender 1986). Postbankruptcy petition advances usually are made under §364 of the Bankruptcy Code (11 USC 5364). In lending under §364, a bank

"(1) may make advances to the (debtor/contractor) without prior court approval but with considerable risk; (2) may obtain the maximum degree of protection by demanding a lien on all of the (contractor's) assets and a superpriority administration claim against the (contractor); or (3) may settle for some degree of protection between these two extremes." Id at 4-18 (footnotes omitted).

The contractor may still be performing on its contract. As discussed above, if the contractor is not in default, the surety does not have an equitable right of subrogation to the unpaid contract proceeds. In this situation, the bank may be advancing funds previously promised to the contractor, or a new lending relationship may have been instituted after the contractor filed its petition. In any event, the lending institution probably will receive an assignment of the contractor's right to the contract proceeds. Subsequently, the contractor may be unable to complete the contract, and the surety will be called upon to fulfill the obligations of its bond. In such a situation, the surety's equitable right of subrogation again will be superior to the bank's right to the contract proceeds. Home Indemnity Company v. United States, 433 F2d 764 (Ct Cl 1970).

Home Indemnity involved a bankrupt contractor who had defaulted on a government job. The contractor had filed a bankruptcy petition prior to its default. While the contractor was reorganizing under Chapter 11, a financing institution lent money to the contractor. The loan was approved by the Bankruptcy Court. After the contractor defaulted both on its construction contract and on its obligation to the financing company, the financing company went bankrupt. The surety fulfilled its obligation on the bond, finished the job, and satisfied the claims of unpaid subcontractors. The surety then filed suit to recover the retainage held by the United States. The financing institution's trustee claimed that, as a creditor with a prior perfected security interest under Article 9 of the UCC, the financing company was entitled to the mntract retainage. Citing the First Circuit's decision in *Shawmut*, the Court of Claims disagreed and held for the surety. 433 F2d at 765.

Any lending institution prepared to make postpetition advances to a contractor in bankruptcy should be aware that its rights to the contract pmceeds may be viable only so long as the surety's equitable rights of subrogation do not come into play upon a default of the contractor. As

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Home Indemnity illustrates, postpetition advances will have a priority inferior to the subrogated rights of a surety even if the postpetition advances were authorized and approved by the Bankruptcy Court.

THE LENDER'S OTHER COMPETITION SUBCONTRACTORS, MATERIAL SUPPLIERS, AND THE TRUSTEE

In a case in which the surety and government were contesting the right to retainage, the United States Supreme Court intimated that subcontractors may have a right to unpaid contract balances if a payment bond surety does not satisfy their claims. ***United States v. Munsey Trust Co.,*** 332 US 234, 242, 91 L Ed 2022 (1947). In holding that a surety which has paid subcontractors is entitled to contract retainage, the Court noted that "laborers and materialmen had a right to be paid out of the (retainage)." ***Pearlman,*** 317 US at 141. See also ***Jacobs v. Northeastern Corporation,*** 416 Pa 417, 206 A2d 49, 53 (1965) (Pennsylvania Supreme Court adopts the rule of ***Pearlman*** "that retainage is not part of the bankrupt's estate and subcontractors have a right to be paid from the fund.")

The ***Jacobs*** court went on to remark in dicta that had the surety not paid the labor and materialmen, the funds held by the government agencies would not have been available to the general creditors. Id, 206 A2d at 54. The court looked upon subcontractors as a group specially protected by statute and by the payment bond which the contractor was required to obtain. Id at 53. While holding that the surety who pays subcontractors is subrogated to the rights of the latter, the court noted that "the funds must be paid to the sureties, just as the funds would have gone, in the absence of a bond, to the labor and materialmen ***rather than to the general creditors."*** Id at *54* (emphasis supplied), citing ***Pearlman,*** supra.

In a more recent Pennsylvania Supreme Court decision, unpaid subcontractors and an assignee bank sought the contract balance on a sewer construction project. ***Himes u. Cameron Couty Const. Corp.,*** 497 Pa 637, 444 A2d 98 (1982). (Though a payment bond had been obtained, the surety had gone bankrupt without performing on its bond.) The Supreme Court held that the unpaid subcontractors' rights to the contract balance were superior to those of the assignee bank. ***Himes,*** 444 A2d at 100. The court based its decision upon language in the contract entered into by the general contractor and the owner. The contract provided that 10 percent of the contract balance would be retained until final completion and proof from the general contractor that all claims for labor, material, and any other outstanding indebtedness had been paid. Id. The subcontractors were held to have priority over the assignee bank because of a provision in the assignment entered into by the contractor and the bank. Under that assignment. the bank was entitled to only those moneys which had become due and payable to the contractor; the retainage was not due and payable to the contractor because of the contractor's failure to pay the subcontractors. Id.

Other courts have held that subcontractors are entitled to recover retained contract balances based upon clauses similar to the proof-of-payment clause contained in the contract in ***Himes.*** These courts have concluded that the subcontractors are third-party beneficiaries of the contract which provides that the owner may retain part of the contract balance until the contractor presents proof of payment of subcontractors. See *Avco* Delta ***Corporation Canada, Ltd. v. United States,*** 484 F2d 692 (7th Cir 1973), cert denied, 415 US 931 (1974); ***Town & Country Bank v. James M. Canfield,*** 55 Ill App 3d 91, 370 NE2d 1977.

THE TRUSTEE

While it should be evident from the discussion above that a lending institution's primary competitor for retained contract balances is the surety on a bonded project, another competitor for the retained contract balance is the general contractor's trustee in bankruptcy. As was noted above, the Supreme Court in ***Pearlman*** held that the retained contract balance is not part of the bankrupt contractor's estate. ***Pearlman.*** 371 US at 135-136. The primary reason for concluding that the contrat balance never becomes part of the bankrupt contractor's estate is that the contractor was in default on the contract and therefore not entitled to the retainage. Id. **Thus,** it would appear that if a contractor in bankruptcy is not in default on its contract obligations, any contract proceeds due and owing would be part of the contractor's estate. Just as a surety has no rights in the contract proceeds until it is called upon to perform on its bond, the contract proceeds will not and cannot be withheld from the contractor until he is in default. Therefore, if the contractor is not in default and entitled to the contract proceeds, the contest will be between the trustee and the bank, which will rely on its assignment in order to recover the proceeds. The surety will have no interest whatsoever absent a default by the contractor. See generally D. Griffin, General Contractor in Proceedings Under the Bankruptcy Code: A Surety's Perspective, at 37-44 (ABA Construction Industry Committee Meeting, New York, New York, January 27, 1983).

CONCLUSION

A surety is generally the party with superior rights to contract funds in a constructin contractor's bankruptcy. However, lenders, the IRS, subcontractors, materialmen, and even the trustee may be able to assert priorities. Lawyers for all of these parties should be attentive to the complexities involved in order to establish the correct priority in a particular case.

Kevin Keily

EEO and DBE/WBE Changes

New state and federal statutes, along with a new compliance team, have once again put equal employment opportunity (EEO) and minority, disadvantaged, and woman-owned business enterprise (DBE/WBE) to the forefront of preventive construction law. The very real threat of substantial fines and debarment on state, federal and federal aid projects has many contractors deeply concerned.

Equal Employment Opportunity Issues: Under Title VII of the Civil Rights Act of 1964 (42 USC §2000e-2(a)), it is unlawful for employers to discriminate on the basis of race, color, religion, sex, or national origin. Under Executive Order 11246, virtually all contractors employing 50 or more persons are required to maintain records of various employment-related events and transmit these to the federal government by filing of Form EEO-1. Executive Order 11246 also prescribes penalties for failure to comply, including termination of contracts and debarment from bidding on future contracts. EO 11246 also requires affirmative action steps. (See 40 CFR §60-1.4).

At the end of the 1986 construction season, the federal government withheld some funds from the Oregon Department of Transportation (ODOT) because of failure of some contractors on ODOT projects to comply with the requirement of Title VII and EO 11246. This sanction against the state, as well as political change, has led to dramatically increased EEO compliance activity. ODOT does compliance audits as designee of the U.S. Department of Labor on federal aid projects. The Office of Federal Contract Compliance Programs (OFCCP) has audit responsibility for federal projects. During the 1987 season there was an 80 percent failure rate on ODOT/EEO audits.

In a nutshell, EEO standards require a comparison of the percentage of hours worked for a federal or federal-aid contractor by employees who are "of color" or who are women, with the total hours worked for that contractor. This is not a head count. To be in compliance with EEO requirements, the percentage of "minority" employee time across all crafts must be in "substantial compliance" with the goals set forth in that particular specification. The goals vary from geographical area to geographical area, of which there are four in Oregon.

An audit for compliance with EEO standards works like this. If a contractor is selected for audit, all of its projects in a particular geographical area are audited, regardless of whether there is federal funding on any particular project. The Compliance Officer will add up all hours incurred on all projects (public or private) over the last quarter by all employees, and determine the percentage of hours worked by all "minority" employees. If the percentage on this blended basis meets or exceeds the goal set for that area, the contractor is in compliance.

A contractor might not meet the established goal for any number of reasons — e.g., a lack of available "minority" workers skilled in a particular craft. In such case, the Compliance Officer is required to look for a "good faith" effort to comply. (See 41 CFR §60-4). Thus, he or she will look for documentation of recruiting efforts, interviews with minority applicants, contact of various state sponsored support services, etc. All contractors are subject to review, whether they are a general contractor, subcontractor, or sub-subcontractor. Material suppliers are not subject to review. Each contractor is responsible for its **own** goals. Therefore, if a subcontractor fails to achieve the goals on its work, the general contractor on the projects of which the sub is working will not be affected.

The compliance audit also consists of a review of payroll records, interviews with employees. review of on-the-job training records, etc. Timeliness and completeness of submission of documentation is also grounds for non-compliance with the EEO requirements. (See 41 CFR §60-1.7).

There are two types of "in compliance" findings. The first is unqualified, and the second is called in compliance with Voluntary Corrective Action Plan (VCAP). The Compliance Officer may find the contractor to be in compliance with a VCAP if there are minor deficiencies — e.g., minor paperwork problems. The contractor then has 30 days to meet the requirements of the VCAP or be found in non-compliance.

When a contractor is found in non-compliance, it is given written notification of the problem within 15 days of the audit. The contractor must then show cause within 30 days why formal proceedings should not be instituted. In essence. this means the contractor has 30 days to correct all deficiencies or submit an acceptable Corrective Action Plan (CAP) which must be fulfilled within 60 days.

A finding of non-compliance is also deemed to be a breach of contract. Under ORS 279.037 a public contracting agency may disqualify a bidder on a public contract if the agency finds that the company has repeatedly breached contractual obligations to public and private contracting agencies. The announced policy of ODOT is that two breaches of contract will automatically give rise to a 90 day debarment.

DBE/WBE Issues: The Surface Transportation and Uniform Relocation Assistance Act of 1987 required amendments to the DBE-WBE programs in all states receiving federal aid. At the same time, the 1987 Oregon legislature passed a bill (ORS 200.005 et seq.) providing major sanctions in the DBE/WBE arena. The result has been a number of extraordinary DBE/WBE certification inquiries and some findings that contractors have been in breach of contract for failure to meet their DBE/WBE obligations.

In summary, virtually all state projects are governed by the following DBE/WBE rules:

1. A combined goal for minority and woman-owned businesses will apply. The statewide average for the 1988

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construction season will be 12 percent. Generally speaking, larger and metropolitan area projects will have larger goals, and smaller projects, smaller goals.

2. Failure to meet the goals will result in the contract being awared to other than the low bidder, unless the low bidder can show "good faith effort" as defined by the Oregon statutes (ORS 200.045) or by 49 CFR §23.45, which certain officials of the Federal Highway Administration (FHWA) believe is more stringent than the Oregon statutes. Only one contractor was able to gain an award on the basis of "good faith efforts" from ODOT and FHWA in Oregon during the 1987 season.

3. ODOT Project Managers are charged with the responsibility for monitoring DBE/WBE compliance with very strong backup and support from the EEO/DBE/WBE Compliance Unit in Salem.

4. ODOT takes the position that the DBE/WBE utilization stated by the contractor in its bid is contractual, and failure to actually meet the stated percentage is a breach of contract subject to various sanctions.

5. General construction industry practice is not applicable to the DBE/WBE arena. Shopping of bids may be required to a "good faith effort" showing. Excessive sub-subcontracting or brokering may be deemed to show a failure of the subcontractor to perform a "commercially useful function (CUF)." The federal regulations define CUF in this way — "Does the MBE, DBE, or WBE firm have a necessary and useful role in the transaction of a kind for which there is a market outside the context of the MBE/DBE/WBE program, or is the firm's role a superfluous step added in an attempt to obtain credit toward goals?"

6. The following sanctions are in force (ORS 200.065 and 200.075):

(a) It is unlawful to fraudulently obtain or retain DBE/WBE certification and attempts to do so may subject the perpetrator to:

1. A civil penalty of ten percent (10%) of the applicable contract or subcontract of $5,000, whichever is less; and.
2. Debarment for up to three years.

(b) Any bidder, contractor, or subcontractor who commits any of the following acts may be debarred for up to ninety days for the first violation and one year for the second:

1. Represent that a DBE/WBE will be performing on a project without the knowledge and consent of the DBE/WBE; or,
2. Exercises management and decision-making control over the internal operations of the DBE/WBE; or
3. Uses a DBE/WBE when the DBE/WBE does not perform a commercially useful function.

(c) Any DBE/WBE that allows or commits any of the following acts will lose its DBE/WBE certification for up to ninety days for the first violation and one year for the second:

1. Use of the DBE/WBE name on a project when the DBE/WBE does not intend to perform; or
2. Use of any personnel of an uncertified business to control the DBE/WBE; or
3. Fails to perform a commercially useful function on a public contract when represented as a DBE/WBE to meet the goal on the project.

For purposes of these sanctions, "commercially useful function" means the actual performance of a function or service by the business for which there is a demand in the market place, and for which the business receives payment not disproportionate to the work performed or in conformance with industry standards. Acting as a broker to provide for the performance of work by others does not constitute a "commercially useful function."

Charles R. Schrader

Professionalism In The Practice of Law

One of the most recent areas of focus for the State Bar Association and some of the local associations has been the topic of "professionalism" in the practice of law. I have written several articles on the subject for the Marion County Bar Association Newsletter.

The subject is an important one I feel for all of us to reflect upon, whether we are practicing trial lawyers or otherwise. The State Bar Association has formed a standing committee to further develop views and to receive feedback from our fellow lawyers. It is hoped that a heightened awareness of the subject will result in a dialogue and a positive growth of the phenomenon.

Following are some excerpts from the articles that I had previously written.

"Professionalism" needs to be defined. As **used** in the context of the Multnomah County Bar Association's guidelines, it means those rules of conduct of the Code of Professional Responsibility. Those **rules** of conduct are often unwritten and guide relationships between lawyers and between the Bench and the Bar.

The Multnomah County Bar Association has written a proposed statement of professionalism in the practice of law. I've also received communications on the subject from judges in Marion County and from other attorneys. It sometimes is called something different but it boils down to the same basic concept: What do we as attorneys need to do in order to promote good feelings, common courtesy, trust, integrity, and other virtues as we go about the business of practicing law?

I believe that it can also be defined as good manners and common courtesy displayed through our professional lives.

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I beleive that there is a crisis concerningthe practiceand observance of professionalism in this state. Others have noted it also and have brought their views to my attention. I have also observed symptoms of the crisis in my own practice. There are a number of reasons for the crisis. Whatever the reasons, the decline of professionalism is one of the reasons why some of the older lawyers tell me that "It just isn't as fun to practice law now as it used to be!" and I agree with them.

I feel that I have one foot in the older generation and one foot in the new. Having practiced law in this state for fifteen years, I have been privy to the "old way" of practicing law, and I can tell you without hesitation that professionalism is much less apparent now that it was then. Not that the old way was a better way in every respect, therearesomeadvantages topracticinglaw in this day and age. But the practice of law is much morestressful now than it was then for just about everyone I have talked to who is from that era, and the decline of professionalism is one of the causes of that increased stress.

Sincestressisoneofthethings we should seek to control or manage, I want to discuss with you some of the techniques that I feel can be used to bring back more professionalism into our legal lives. The Multnomah County Bar Association has given us several principals of practice to aid in professionalism. I applaud their efforts and hope that their efforts as well as the efforts of other associations and individuals will some day result in a consensus on what professionalism is in the practice of law.

What I am going to talk about is the result of observations of my own self and somegeneralizationsthat I have had over the last few years as to how I practice law as a person and how I have unwittingly contributed to the decline of professionalism. I believe that a person cannot change anyoneelse or the world until they themselves have experienced that change that they seek to effect. The remarks for the most part apply to myself and help to point out the root causes of the lack of professionalism. Another way of saying it is that you cannot expect professionalism unless you give professionalism.

Let me begin by stating that professionalism is not a set of rules of conduct or things that you do and don't do. We could make up list after list and all agree on what we need to do in order to be more professional but that would still not address the basic underlying causes of lack of professionalism. Professionalism is an attitude, and not only an attitude about the practice of law, but an attitude toward life in general. One of the first steps is an awareness of the concept of professionalism. One must have a realization that there is such a thing. Efforts of the Multnomah County Bar, Oregon State Bar, and this article are what bring about awareness. Education is part of the awareness.

Another step is the desire on the part of the individual to conform to the generally accepted standards of professionalism. This desire must be voluntary and must come from the awareness coupled with an incentive to observe and conform. That incentive must be a positive incentive, i.e. it cannot be based on sanctions for violations of rules but must bereinforced by positive results. There are two reasons for me saying this. First, I don't think that the legal profession needs any more rules governing personal behavior and secondly, any movement toward professionalism based on negative incentives will not be a true transformation of individual conduct and will eventually fail.

A third step is the acceptance ofindividualresponsibility for professionalism. Responsibility as used here, means the willingness to see ourselves as the source of the conditions and circumstances in our lives. This is the process of assuming 100% responsibility for the results that we produce. **Considerthatlikebegatslike,** angerbegatsanger. courtesy begats courtesy, etc.

This may take quite a leap of faith when we are confronted with someone who is obnoxious, rude, loud, cantankerous, or downright not to be trusted. However, if we ourselves constantly try to live professionalism, those types will become extinct because the environment will simply not support them.

I believe that a fourth step is for each of us to reexamine the nature and extent of our competitive urge. For many of **us,** part of the reason we are attorneys is because we are driven to excel, we are competitive by nature, and our professionalism certainly fosters those traits in most area8 of practice. If our competitive drive is fueled by a drive to be superior, I believe that it causes problems.

I quote from a book by William Guillory called ***Realizations.*** "There is an alternative way of achieving and excelling which is not driven out of the necessity of being superior. It could be described by the expression 'friendly competition', where we don't confuse the pursuit as being dependent on survival. It's like being on a parallel track and not constantly observing a competitor with suspicion, envy and distrust. There is an atmosphere of sharing and mutual support. In a like manner, this way of being in competition brings with it a sense of satisfaction and contribution, rather than the disabling consequences of stress."

Finally, at least for this article, we must at all times compare our declarations with our performance. "Iswhat I say what I do?" A great number of gaps between what we say and what we do are not intentional and are the result of inadvertence, forgetfullness, lack of attention or awareness, carelessness in what we promise, and lack of follow up. If we are aware of the concept, we will begin to closethegap between whatwesayandwhatwedoinevery aspect of our personal and professional lives. When that is done, we will be truly responsible.

Michael Mills

– Notice –

Dick Alexander and Steve Schell, coeditors, state it will not be long now. The Oregon State Bar's first CLE book on construction law is expected to be published in early 1989. A listing of the chapters and authors are as follows:

1.	Licensing and Registrations	Alan R. Merkle
2.	Legal Relationship Between Owner/Design Professional, Contractor/Subcontractors/ Suppliers	Guy Randles
3.	Owner-Contractor Relationship With the Lender	F. Gordon Allen Gregory B. Snook
4.	Contracts Competitively Bid and Negotiated (Public and Private	Daniel J. Seifer
5.	Bid Disputes	John F. Bradach
6.	Subcontract and Purchase Orders	Elizabeth H. Yeats
7.	Owner-Architect/Engineer Agreements	Gregory A. McKenzie
8.	Standard Form Contracts	Rodney R. Mills
9.	Construction Insurance	Charles Schrader
10.	Documentation	William C. Tharp
11.	Claims	Thomas H. Anderson David P. Roy
12.	Liability of the Design Professional	David F. Bartz, Jr.
13.	Federal Contracts	J. William Bennett
14.	Construction Liens	Michael J. Scott
15.	Damages Under Construction Agreements	Arnold L. Gray
16.	Arbitration of Construction Disputes	D. Craig Mikkelson
17.	Performance and Payment Bonds	Douglas A. Stamm
18.	The Rights and Liabilities of Sureties	J. Terrence Bittner
19.	Problems With Bankruptcy and Workouts on Construction Projects	Ronald T. Adams James F. Dalton
20.	Single Family Home Construction	Jeff Hachrach
21.	Miscellaneous Tax Labor	Michael J. Silver Layton Pace Kenneth Jernstedt

Two mini-seminars will highlight Construction Section activities in the upcoming months.

The Executive Board of the Construction Section has approved the Section's sponsorship of a mini-seminar to be held July 29, 1988 in Salem, and a mini-seminar concerning ethics in construction practice to be held in conjunction with the Bar's annual meeting in Eugenethis September.

The Continuing Legal Education subcommittee of the Section is also planning a major CLE presentation to correspond with the upcoming release of the Oregon State Bar's Handbook on Construction Law presently being edited by Dick Alexander and Steve Schell.

The July 29, 1988 mini-seminar is scheduled for approximately two hours in the afternoon. Further information concerning that seminar will be provided to Section members in the upcoming weeks. Fritz Batsonand Kevin Kiely are co-chairing the planning committee for this mini-seminar.

The September mini-seminar will focus on establishing practice guidelines to recognize, address and resolve ethical concerns in the day-to-day construction law practice. Persons interested in assisting or attending in either mini-seminar may contact Mike Scott for further information, 620-4540.

In other section Executive Board matters, Chuck Schrader. the Executive Board's Chair-Elect, is coordinating the section's involvement in legislative matters for the 1989session of the Oregon legislature and the Section's Nominating Committee for membership on its Executive Board.

The Construction Section has an established policy of not taking an official pro or con position on proposed legislation. The Section does, however, closely monitor all construction related legislation so that section members can be aware of potential statutory changes and can offer their views or those of their clients before the respective legislative committees. Persons interested in participating in the Section's Legislative Committee should contact Chuck Schrader, 224-0055.

Addendum # One To The Plans and Specifications For Most Public Agency Projects

1. The work we want did is clearly on the plans and specifications. Our designer, whose had plenty of college, spent one heck of a lot of time when he drawed up these here plans and specifications. But nobody cannot think of everything! Once your bid is in, that's it Brother! From then on, anything wanted by our designer, or any of his friends, or anybody else (except the Contractor) shall be considered as showed, specified or implied and shall be provided by the Contractor without no expense to nobody, but himself (meaning the Contractor).

2. If the work is did without no extra expense to the Contractor, then the work will be took down and did over again until the extra expense to the Contractor is satisfactory to our designer.

3. Our designer's plans is right as drawed. If something is drawed wrong, it shall be discovered by the Contractor, corrected, and did right with no extra expense to us. It won't cut no ice with us or our designer if you point out mistakes our designer has drawed. If you do, it will be one heck of a long time before you do any more work for us or him (meaning the Contractor).

4. The Contractor is not suppose to make fun of our designer, his plans, or the kind of work we're having done. If he do, it's just too bad for him (meaning the Contractor).

5. Any contractor walking around the job with a smile on his face is subject to the review of his bid.

6. If the Contractor don't find all our designer's mistakes before he bids the job, or if the Contractor ain't got enough sense to know that our designers is going to think up a bunch of new stuff that's goint to have to be did before the job is completely did, then it's just too bad for him (meaning the Contractor).

7. The Contractor gotta use all good stuff on this job — none of this stuff from places we can't pronounce.

The executive committee members of the O.S.B. Construction Law Section urge you to become an active member of the section. Educational program and newsletter reports will be part of the many benefits available to section members. All members of the Oregon State Bar Association are eligible ...*Join* Today!

Please enroll me as an active member of the O.S.B. Construction Law Section. My $10.00 annual dues are enclosed. Send this coupon and check to:

Construction Law **Section**

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I am not a member of the Oregon State Bar but I want to receive your newsletter. My $10.00 is enclosed.

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