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July 20, 2015

Mr. Shawn T. Blume  
Pinnacle Surety  
151 Kalmus Drive, Ste. A-201  
Costa Mesa, CA 92626

Re: Pinnacle Surety/General  
Opinion Letter re: Prequalification Procedures

Dear Mr. Blume,

You have asked for an opinion letter generally regarding the use of prequalification procedures in public contracting, and specifically regarding the prequalification questionnaire developed by the Irvine Unified School District (IUSD). As described more fully below, prequalification generally does not advance the public interests established by the California Legislature and discussed by courts, and in specific instances like IUSD's prequalification questionnaire, can serve to reduce transparency in the bidding process, diminish competition, and serve as a conduit for favoritism and abuse. Ultimately it is this firm's conclusion that prequalification procedures increase the likelihood that competent and qualified contractors will be excluded from the bid process and that, as a result, public funds will be misused and wasted.

The Public Contract Code includes a legislative statement of purpose that establishes the objectives for California's public bidding scheme. Those objectives include:

1. Protecting the public from the misuse of public funds;
2. Providing all qualified bidders with a fair opportunity to bid on public projects;
3. Stimulating competition for public contracts; and
4. Eliminating favoritism, fraud, and corruption in the awarding of public contracts.  
(See California Public Contract Code § 100-102.)

Of the enumerated objectives, eliminating favoritism, fraud, and corruption receives the most attention in judicial decisions. For example, in *City of Inglewood – Los Angeles County Civic Center Authority v. Superior Court of Los Angeles* (1972) 7 Cal. 3d 861, the California Supreme Court held that construction management contracts *must* be awarded to the lowest responsible bidder because allowing such contracts to be awarded through non-competitive bidding could “open the door to *possible* favoritism, fraud or corruption in the letting of public construction contracts.” (Id. at 866.) The law seeks to prevent not only actual occurrences of favoritism, fraud, and corruption, but also the mere possibility that public contracts will be awarded unfairly. The Court in *City of Inglewood* also cited with approval a party’s characterization of the underlying purpose of public bidding, writing,

To permit a local public works contracting agency to expressly or impliedly reject the bid of a qualified and responsible lowest monetary bidder in favor of a higher bidder deemed to be more qualified frustrates the very purpose of competitive bidding laws and violates the interest of the public in having public works projects awarded without favoritism, without excessive cost, and constructed at the lowest price consistent with the reasonable quality and expectation of completion. (7 Cal. 3d 861 at 867).

The Public Contract Code establishes a bidding procedure that is intended to be transparent and impartial, maximize competition, and ensure the judicious use of public funds. Under the traditional bid process established in the Public Contract Code, public agencies solicit bids and award contracts to the lowest bidder who is both responsive and responsible. The public call for bids ensures that all interested contractors have a fair opportunity to participate, thereby stimulating competition. The transparency of the public process and limited authority to reject bids helps to dissuade favoritism, fraud, and corruption. Public entities also have the ability to reject bids from irresponsible or unqualified bidders, thereby ensuring that public funds are not misused or wasted.

Responsiveness is determined by comparing the bid requirements with the contractor’s bid. If the bid submitted follows the bid instructions and provides all necessary information, it is responsive. (See *Taylor Bus Service, Inc. v. San Diego Board of Education* (1987) 195 Cal.App.3d 1331, 1341.) Responsiveness is essentially a question of whether a bidder has correctly filled out the bid forms.

Responsibility, on the other hand, reflects on the bidder’s ability to perform the contract, and implicates the bidder’s trustworthiness, competence, quality of work, and capacity to complete the work. (See *City of Inglewood – Los Angeles County Civic Center Authority v. Superior Court of Los Angeles* (1972) 7 Cal. 3d 861, 867.) Responsibility is a much more difficult question than responsiveness, and carries much greater weight. As the Court of Appeals stated in the *Taylor Bus* decision, “a determination that a bidder is responsible is a complex matter dependent, often, on information received outside the bidding process and



requiring, in many cases, an application of subtle judgment.” (195 Cal.App.3d 1331 at 1342.) An adverse finding with respect to responsibility has enduring consequences for a contractor. Such a finding publically brands a contractor as not qualified, incompetent, and untrustworthy, and must typically be disclosed when bidding with other public agencies. Being found non-responsible often serves as a death knell for contractors.

The prequalification process authorized in the Public Contract Code is the mechanism public agencies use to determine potential bidders’ responsibility before bids are solicited and received. Consequently, the prequalification process must be comprehensive enough to allow the “subtle judgments” that are required when determining a contractor’s quality, trustworthiness, and fitness, while also being narrowly tailored to ensure fair access and promote competition. Because even the mere *appearance* or *possibility* of fraud, favoritism, or corruption is abhorrent in public bidding, the process must be transparent, inclusive, and not a means to funnel contracts to preferred bidders.

With respect to School Districts, Public Contract Code § 20111.5 permits prequalification but does not compel Districts to use the process. Districts are permitted to develop and utilize a standardized questionnaire, may require prospective bidders to submit a financial statement, and may consider the bidder’s financial capacity and experience in performing public works. (See Public Contract Code § 20111.5(a)) The law constrains Districts’ authority by requiring them to adopt “a uniform system of rating bidders on the basis of completed questionnaires and financial statements, in order to determine the size of the contract upon which each bidder shall be deemed qualified to bid.” Further, if a contractor is disqualified, it must be provided with a written notice outlining the basis for disqualification and any supporting evidence that the District considered, and be provided an opportunity to present its own evidence as to why it should be found qualified.

In 2012, the legislature enacted AB 1565, which makes prequalification *mandatory* for projects greater than \$1 million that are funded by the Leroy F. Green School Facilities Act of 1998 or any future state school bonds. (See Public Contract Code § 20111.6). Public Contract Code § 20111.6 directs Districts to develop a standard questionnaire that addresses, at minimum, the issues that appear in the model forms that were developed by Department of Industrial Relations (DIR) for general prequalification use by public agencies.

The DIR model questionnaire is divided in three parts: Essential Requirements, Organizational History, and Recent Projects. The Essential Requirement section can lead to immediate disqualification, but disqualifying criteria are extremely limited. Examples include:

1. Failure to possess a valid contractor’s license;
2. Recent history of license revocation;

3. Lack of liability or workers compensation insurance;
4. Failure to submit evidence of bonding capacity;
5. Prior termination for cause that resulted in the surety completing the project;
6. Current debarment from public contracting that results from labor code violations; and
7. Recent conviction of a crime involving public contracts.

In general the DIR model form suggests that only serious deficiencies that would be grounds for legal disqualification or would routinely result in an adverse responsibility finding by an awarding agency should be used as grounds for immediate disqualification.

The Organizational History and Recent Project sections of the DIR model form are exceptionally comprehensive, covering everything from ownership structure, related entities, and financial history to labor compliance, litigation, and safety violations. Awarding agencies are encouraged to solicit and review information concerning the bidders' six most recent public works, the three largest private works completed within the past three years, and other projects that are similar to projects the contractor expects to bid, and to randomly select at least two project contacts for interviews concerning the contractor's performance.

It is important to note that none of the questions in the Organizational History or Recent Project section are automatically disqualifying. The DIR developed a numerical scoring rubric that allows contractors to prequalify even if they are newly formed, have filed for bankruptcy, have litigated multiple claims against owners in the past, or have numerous prevailing wage violations on record. In a general sense, the purpose of the DIR model prequalification questionnaire does not appear to be to *exclude* contractors as unqualified, but rather to compile a broad array of information that allows public agencies to consider the full breadth and depth of a contractor's experience which, in turn, makes prequalification more inclusive, not less.

The Irvine Unified School District Prequalification Questionnaire, on the other hand, is structured in much more exclusionary manner, and appears to be designed to exclude all but the largest contractors in the school construction market. To illustrate, the first three questions posed in the IUSD questionnaire are as follows:

1. Has your firm contracted for an completed at least five separate construction projects during the past five years for a California K-14 public school district or California community college district[...]?
2. Has your firm held for the past five years without revocation or suspension all contractors licenses necessary to perform the scope of work you will bid on for a



Project?

3. Has your firm and/or any firm identified above in Section B and/or Section C defaulted on a contract within the past five years or declared bankruptcy or been placed in receivership within the past five years?

All three of the questions above are grounds for immediate disqualification in the IUSD questionnaire, but none would result in immediate disqualification under the DIR model form. In effect, IUSD has taken the position that *only* contractors that have been in existence and licensed since at least 2010, regularly completed California public school projects from 2010 to 2015, and who were fortunate enough not to have to seek bankruptcy protection during the great recession possess the most basic qualifications to work at Irvine Unified School District.

The potential for exclusion of qualified potential bidders cannot be overstated. Hypothetically, the following (fictitious) contractors that would be deemed unqualified by IUSD:

1. An out-of-state contractor with twenty years of school-construction experience that is seeking to enter the California market;
2. Any newly formed company, even if it is owned and operated by individuals with extensive experience in public-works;
3. A contractor who has successfully completed four large school projects in the past for years, but not a fifth;
4. Contractors who may have had extensive experience in school construction prior to the recession but who chose to focus on private works when public projects were scarce;
5. A contractor that sought financial reorganization under the bankruptcy code in 2011, but which has operated successfully and profitably since reorganization.

These types of contractors are almost certainly not the types of contractors that would be found to be not responsible in a traditional bid setting. The criteria IUSD applies to immediately disqualify contractors does not necessarily indicate that those contractors are inherently untrustworthy, incompetent, or unable to perform a contract. Put simply, IUSD limits its bidding pool to contractors who had, for the five years prior, routinely completed school projects. All others are presumed to be unqualified.

Another issue in IUSD's prequalification questionnaire worth noting is its bond requirement. If a contractor is prequalified, it is only permitted to bid on contracts up to 50% of its aggregate bonding capacity. Even if the contractor's surety is willing to provide a single-project bond in an amount greater than 50% of the aggregate capacity, IUSD has determined that

the contractor is not capable or permitted to perform that contract. Why such a limitation is desirable or even appropriate is not clear from our review. If an admitted surety is willing to provide payment and performance bonds to a contractor, then the District bears no liability – its interests are secured, and the surety assumes liability in the event of default. The effect of the bond capacity limitation is to further exclude qualified contractors that are able to secure appropriate bonds.

Finally, IUSD has instituted measures to limit the transparency of its prequalification process. While it is legally required to provide a written memorandum stating its basis for disqualifying a contractor, IUSD states that it “will not release or otherwise provide [the] Contractor with any information obtained from [the] Contractor’s references or any of the completed ‘Prequalification Evaluation Reference Form[s]’.”

When viewed in its totality, IUSD’s prequalification questionnaire appears to be designed to limit the pool of applicants for District projects to a select group of large and well capitalized contractors that are regular competitors in the school-construction market. New firms or those that did not actively complete school projects during the great recession are excluded, and only those with the highest bond capacities will be deemed qualified to bid on the largest projects.

This type of protectionism and apparent favoritism directly contradicts the overarching purpose of public bidding as established by the Legislature and routinely reinforced by the courts. Limiting the number of potential participants who may bid on projects eliminates competition for District contracts, which in turn raises prices and wastes public funds. Fair and open access to public contracts is effectively eliminated. Transparency in the process, which is intended to dissuade favoritism, fraud, and abuse, is absent, because contractors are not able to review the documents that constitute the District’s evaluation forms. In short, the prequalification process IUSD has adopted in no way furthers the objectives the Legislature has established, and in fact appears to subvert them.

Finally, IUSD’s prequalification questionnaire is only one example of the overarching problem with the prequalification process the Legislature has authorized. The ultimate issues of fairness and open competition for public contracts cannot be pursued on a district-by-district or agency-by-agency basis. The real problem lies with deficiencies in the authorizing statutes themselves (Public Contract Code § 20111.6, among others). While all Districts are required to include the issues that appear in the DIR’s model forms, they are free to design their own scoring methodologies or add additional criteria as they deem necessary. No standardized procedure has been established, nor does any agency have oversight to review questionnaires or reject patently anti-competitive processes. By permitting each District and public agency to establish their own prequalification criteria and procedure, the Legislature almost ensured that favoritism would enter the public bidding process.



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Prequalification provides easy cover for favoritism and allows public agencies, including school districts, to limit fair access to public contracts by way of thinly veiled "objective criteria" that are designed to exclude non-favored bidders. By mandating the use of prequalification for school districts, the Legislature has perhaps unwittingly subverted their own stated goals and permitted public contracts to be funneled to the select few, thereby wasting precious and limited public funds.

It is this firm's opinion that a rejection of prequalification and return to traditional public bidding, where all those with the ability and capacity to complete a project are permitted to bid, is the only means to ensure that public contracts are awarded without favoritism, and constructed at the lowest price consistent with reasonable quality. Until that happens, IUSD should use the DIR model forms, and not use a form that appears to foster fraud, favoritism, corruption and bribery.

Very truly yours,



Mark A. Feldman  
for FELDMAN & ASSOCIATES, INC.



Kevin M. Hannifan  
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