IN THE COURT OF COMMON PLEAS OF PHILADELPHIA COUNTY
FIRST JUDICIAL DISTRICT OF PENNSYLVANIA
TRIAL DIVISION – CIVIL

ERNEST BOCK & SONS, INC.,	:	MAY TERM, 2011
Plaintiff	:	NO. 02633
v.	:	COMMERCE PROGRAM
CITY OF PHILADELPHIA, et al.	:	Control Nos.: 13082093, 13082095, 13082113
Defendants.	:	

ORDER

AND NOW, this 2nd day of January, 2014, upon consideration of the City of Philadelphia's (the "City's") Motion for Summary Judgment, Ernest Bock & Sons, Inc.'s ("EBS'") Motion for Summary Judgment, EBS' Motion to Strike Expert Report, the responses thereto, and all other matters of record, and in accord with the Opinion issued simultaneously, it is **ORDERED** as follows:

1. The City's Motion for Summary Judgment is **GRANTED in part**, and judgment as to liability only is entered in favor of the City and against EBS with respect to the City's Counterclaim that EBS breached the MBE Participation Requirement of the 1B Contract.
2. EBS' Motion for Summary Judgment is **GRANTED in part,** and the court holds that the Liquidated Damages Provision connected to the MBE Participation Requirement of the 1B Contract is an unenforceable penalty in this instance. Reasonable damages, if any, to be awarded to the City will be determined at trial.

3. EBS' Motion to Strike[1] and the remainder of the Motions for Summary Judgment are **DENIED.**

BY THE COURT:

PATRICIA A. McINERNEY, J.

[1] EBS seeks to strike the City's Counterclaim for breach of the Self Performance Requirement of the 1B Contract for failure properly to plead it. Amendments of pleadings to conform to the evidence are generally allowed, so the court will not prohibit the City, at this point, from offering such evidence. *See* Pa. R. Civ. P. 1034.

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OPINION

This case is one of several arising out of renovation projects at the Philadelphia International Airport. The City of Philadelphia (the "City") as owner of the Airport entered into a contract with Ernest Bock and Sons, Inc. ("EBS") as general contractor to perform work on Phase 1B of the renovation (the "1B Contract"). The 1B Contract contains the following provision:

> Performance of Work by the Contractor The Contractor shall perform on the site and with its own organization and work force, at least twenty percent (20%) of the total amount of work to be performed under the Contract. The Contractor shall submit with its Bid a complete description of the work it will perform with its own organization (e.g., earthwork, paving, brickwork, roofing, etc.), the percentage of the total work this represents, and the estimated cost thereof. at least 20% of the total amount to be performed under the contract [sic].
> (the "Self Performance Requirement")

Pursuant to this provision, EBS agreed to perform 21%, or approximately $6.5 million, of the work under the 1B Contract.

The 1B Contract also requires EBS to employ Minority Owned Business Enterprise ("MBE") subcontractors to perform a portion of the work (the "MBE Participation Requirement"). EBS agreed to engage MBEs to perform 12% plus $450,000 of the 1B Contract work. The MBE Participation Requirement further provides:

[MBE] subcontractors must perform at least fifty percent (50%) of the cost of the subcontract (not including the cost of materials, equipment or supplies incident to the performance of the subcontract) with their own employees.

* * *

[MBE] percentage commitments are to be maintained throughout the term of the contract and shall apply to the total contract value (including approved change orders and amendments.) Any change in commitment, including but not limited to substitutions for the listed firm(s), changes or reductions in the work and/or listed dollar/percentage amounts, must be pre-approved in writing by the MBEC.

* * *

The successful bidder shall maintain all books and records relating to its [MBE] commitments (e.g. copies of quotations, subcontracts, joint venture agreement, correspondence, cancelled checks, invoices, telephone logs) for a period of at least three (3) years following acceptance of final payment. These records shall be made available for inspection by the MBEC and/or other appropriate City officials.

* * *

The successful bidder's . . . fulfillment of any [MBE] commitments is material to the contract. Any failure to comply with these requirements constitutes a substantial breach of the contract. It is further understood and agreed that in the event the Director of Finance determines that the successful bidder hereunder has failed to comply with these requirements the City may . . . exercise one or more of the following remedies, as deemed applicable, which shall be deemed cumulative and concurrent:

a. Withhold payment(s) or any part thereof until corrective action is taken.
b. Terminate the contract, in whole or in part.
c. Suspend the successful bidder from bidding on and/or participating in any future City contracts for a period of up to three (3) years.
d. Recover as liquidated damages, one percent of the total dollar amount of the contract for each one percent (or fraction thereof) of the commitment shortfall. (NOTE: the "total dollar amount of the contract" shall include approved change orders, amendments . . .") (the "Liquidated Damages Provision").

In their cross-Motions for Summary Judgment, the parties raise a number of issues regarding these provisions, but only three require analysis here:

1. Whether EBS can include the work of related entities towards the organizational total set forth in the Self-Performance Requirement?

2. Whether EBS failed to comply with the MBE Requirement?

3. Whether the Liquidated Damages Provision of the MBE Requirement is an unreasonable penalty?

The court finds that all these questions must be answered in the affirmative.

I. The Self Performance Requirement.

Under the Self Performance Requirement, EBS was supposed to perform 21% of the 1B Contract work "with its own organization and work force." The City claims that EBS performed, at most, $2,317,444 out of the $7,915,822 worth of work it should have completed itself. EBS claims that it and its related companies performed $8,038,968 of the total work under the 1B Contract. An "organization" is defined as "something made up of elements of varied functions that contribute to the whole and to collective functions; an organism; a group of persons organized for a particular purpose; an association."[2] To the extent EBS can show that its related entities, with whom it apparently shares combined financial statements, constitute parts of a whole and are not entirely separate entities, then it may be able to show that it satisfied the Self Performance Requirement of the 1B Contract.

II. The MBE Requirement.

Under the MBE Requirement, EBS was supposed to have one or more MBEs perform 12% plus $450,000 of the 1B Contract work, which the City claims totals $5,228,970 out of the $39.8 million contract amount. Instead, an audit of the project by the City Controller showed that EBS' original MBE subcontractor and its replacement MBE subcontractor simply took a 3% fee off the top and passed the actual work along to non-MBE subcontractors. EBS does not dispute these facts, but argues instead that it had difficulty finding a MBE subcontractor who could actually do the work. EBS also points out that it had other MBE subcontractors perform almost $600,000 of work on the 1B Contract, which is less than 2% of the total contract value. Neither of these assertions of fact is sufficient to satisfy EBS' duty to comply with the MBE Participation Requirement. Therefore, EBS has breached that provision of the 1B Contract.

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[2] American Heritage Dictionary, p. 1275 (3rd Ed. 1992).

III. The Liquidated Damages Provision.

The City claims that, under the Liquidated Damages Provision, it is entitled to recover over $5 million from EBS as a result of EBS' breach of the MBE Participation Requirement. Much of that $5 million was apparently paid to non-MBE subcontractors to perform work for the City under the 1B Contract, although some of it may also have lined the pockets of the pass-through MBE and of EBS itself in the form of "overhead." EBS argues that such an award of damages amounts to an unreasonable penalty, which bears no relation to the actual damages suffered by the City as a result of EBS' breach of the MBE Participation Requirement.

> Nearly a century ago our Supreme Court quite aptly articulated the policy against the enforcement of penalties in actions ex contractu:
>
> > Where the breach of agreement admits of compensation, the recovery may be limited to the loss actually sustained, notwithstanding a stipulation for a penalty. This rule is founded upon the principle that one party should not be allowed to profit by the default of the other, and that *compensation* and not forfeiture is the equitable rule.
> >
> > * * *
>
> Where a stipulated damages clause is intended as a form of punishment with the purpose, in terrorem, to secure compliance, the principles of compensation are subordinated and the provision must fail as an unenforceable penalty.
>
> To assist in making this distinction, our courts have employed certain rules of construction that are commonly thought to provide the best indication of the parties' intent.
>
> > The question of whether stipulation is a penalty or a valid liquidated damages provision is to be determined by the intention of the parties, drawn from the words of the whole contract, examined in the light of its subject-matter and its surroundings; and in this examination we must consider the relation which the sum stipulated bears to the extent of the injury which may be caused by the several breaches provided against, the ease or difficulty of measuring a breach in damages, and such other matters as are legally or necessarily inherent in the transaction.
>
> Th[e Superior C]ourt also has cited with approval section 339 of the Restatement (First) of Contracts:

> An Agreement, made in advance of breach, fixing the damages therefor, is not enforceable as a contract and does not affect the damages recoverable for breach, unless
>
> (a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and
>
> (b) the harm that is caused by the breach is incapable or very difficult of accurate estimation.[3]

The harm caused by EBS' breach of the MBE Participation Requirement may be difficult to estimate accurately, although the City's expert has attempted to do so. However, there is no evidence that the Liquidated Damages Provision is a reasonable forecast of just compensation for EBS' breach. It is patently unreasonable to require EBS to disgorge the entire amount that should have been paid to an MBE without considering how much of that payment was expended for necessary work already completed for the benefit of the City, albeit by a non-MBE. The court will not blindly apply the Liquidated Damages Provision because it amounts to an excessive penalty in this instance. Instead, the court will defer to the finder of fact to determine reasonable and appropriate damages for EBS' breach of the MBE Participation Requirement.

By invalidating the Liquidated Damages Provision of the 1B Contract, the court does not mean to belittle the importance of the MBE Participation Requirement, which as a matter of public policy must be strictly enforced. The City argues that failure to apply the Liquidated Damages Provision will undermine this important public policy by taking away the incentive to comply with the MBE Participation Requirement.[4] The court notes that, under the 1B Contract,

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[3] Hanrahan v. Audubon Builders, Inc., 418 Pa. Super. 497, 501, 614 A.2d 748, 750 (1992); Holt's Cigar Co. v. 222 Liberty Associates, 404 Pa. Super. 578, 587-8, 591 A.2d 743, 748 (1991).

[4] The case relied upon by the City is inapposite because it involves statutory liquidated damages, not contractual ones. *See* Pantuso Motors, Inc. v. Corestates Bank, N.A., 568 Pa. 601, 610, 798 A.2d 1277, 1283 (2002) ("[I]t must not be overlooked that the damage award here at issue was calculated by reference to legislative enactment, not contractual stipulation. Manifestly, absent constitutional infirmity the courts of this Commonwealth may not refuse to enforce on grounds of public policy that which the Legislature has prescribed.")

the City has reserved several quivers for its bow, the most damaging of which is the debarment provision. The threat of being prohibited from bidding on future City contracts for up to three years, as happened to EBS here,[5] should be quite sufficient to deter a contractor from failing to comply with the MBE Participation Requirement.

CONCLUSION

For all the foregoing reasons, the City's and EBS' cross-Motions for Summary Judgment must be granted in part and denied in part.

Dated: January 2, 2014

BY THE COURT:

PATRICIA A. McINERNEY, J.

[5] Pursuant to the "Disposition Agreement" between the City and EBS, EBS agreed not to bid on City contracts from August 1, 2010 through April 1, 2012.