



By Bryan C. Jackson

Under Construction

Risk management strategies in the construction industry need to be built around both containment of litigation and preparation for natural disasters

alifornia's construction industry perceives itself as besieged by three significant legal developments that are raising lending costs, liability risks, fees, and emergency costs. First, owners must now secure their payments to contractors under Civil Code Section 3110.5. Second, Senate Bill 800, the California Legislature's mechanism to discourage construction defect litigation, may not succeed, despite its lofty intentions. Third, developers who unknowingly fail to obtain contractor's licenses are in some instances facing the possibility of having to disgorge all their fees under recent amendments to Business and Professions Code Section 7031(b). In addition to these legislative changes, owners, contractors, and developers must address increasing risks to their projects from natural disasters and acts of violence by implementing effective and comprehensive crisis management plans.

Civil Code Section 3110.5

Civil Code Section 3110.5 became effective January 1, 2002. For decades, contractors used "pay-if-paid" clauses to forestall paying their subcontractors until the owner paid the contractor. In 1997, two courts held that pay-if-paid clauses constituted unconstitutional waivers of the subcontractors' mechanics' lien rights. The courts argued that if contractors were never paid by the owner, the subcontractors' lien rights would never ripen. The most obvious solution to this alleged waiver of lien rights would have been to allow subcontractors the right to record their liens on an owner's property once the owner's undisputed payment to the contractor was more than 30 days late, even if a pay-if-paid clause was present in the subcontract. However, when the courts struck down the pay-if-paid clause, they unknowingly placed contractors in the role of financial guarantors who might be required to pay their subcontractors prior to receiving payment from the owners.

Seeking to relieve contractors from this alleged guarantor role and instead of strengthening traditional remedies for nonpayment

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(such as mechanics' liens, stop notices, prompt payment statutes, bond remedies, 10day work stoppage rights, and contract rights),2 lawmakers created Civil Code Section 3110.5.3 Specifically, Section 3110.5 requires nonexempt owners of private, nonresidential projects costing over \$5 million, or owners with less than a full interest in a project costing over \$1 million, to provide either a payment bond, an irrevocable letter of credit (LOC), or an escrow account for the benefit of the contractor. The bond, LOC, or escrow account must be 25 percent of the contract amount for projects with construction schedules under six months, and 15 percent for all other projects. The intended purpose of the statute is to secure timely payment to the contractor and thereby provide the contractor with access to funds to pay subcontractors upon the owner's default.

In practice, Section 3110.5 may not fulfill its purpose. Unless counsel prepares for the potential pitfalls of Section 3110.5, a contractor may still be liable to its subcontractors without a prompt remedy against the owner when the owner defaults on its payment obligations. For example, Section 3110.5 allows the owner, but not the contractor, the right to choose either bonds, LOCs, or escrow accounts. Bonds must be issued by a California admitted surety and be "payable upon default by the contracting owner of any undisputed amount under the contract that has been due and payable for more than 30 days." An owner may dispute its alleged late payment, thereby preventing timely payment to the contractor through the bond, and leaving the contractor liable to the subcontractor until the dispute is resolved.

To prevent such delays, construction counsel should avoid disputes by ensuring that change orders are executed prior to performing any additional work and that monthly invoices strictly comply with the requirements found in the construction contract. A construction contract often requires lien release forms from all subcontractors and suppliers and documentary backup for all invoiced amounts. Contractor's counsel also should include precise definitions of an owner's "default" in construction contracts, bonds, LOCs, or escrow accounts.

LOCs must be provided by a "financial institution" as defined in Financial Code Section 5107, and they must "inur[e] to the benefit of the original contractor," with a maturity date and terms to be determined by agreement among the owner, original contractor, and the issuer of the LOC. The LOC must be maintained "until the contracting owner has satisfied all of its payment obligations to the original contractor." Of the three security options, the LOC allows for the most

flexibility for parties in devising their terms. Thus contractor's counsel may draft the LOC to clearly define an "event of default" and avoid payment delays.

Section 3110.5 defines "escrow accounts" with the most detail. The escrow holder must be licensed or exempt from licensing under the Escrow Law contained in the Financial Code. The escrow account must be located in California. Also, the owner must establish that the contractor has "a perfected, first priority security interest" in the escrow account. Priority may be established by written opinion of counsel, although this may increase transaction costs and malpractice risks when using escrow accounts.

Under the terms of the statute, and by implication, the bonds, LOCs, or escrow accounts should be limited to the financial obligations of the owner to make timely payments of undisputed amounts under the contract.

Under Section 3110.5, owners have only 10 days to post security after a contractor's demand, or the contractor can stop all work. Because Section 3110.5 cannot be waived, owner's counsel should search for possible exemptions. For example, majority owners of the contractor are exempt from posting security. Also, owners that are companies with "investment grade" nonsubordinated debt securities traded on the New York, American, or NASDAQ stock exchanges are deemed "qualified" and also are exempt. If a qualified company's stock is downgraded below investment grade, the company will no longer be exempt from Section 3110.5. Also, an owner is excluded if it is a wholly owned subsidiary of a qualified company, provided the parent guarantees "the obligations of the subsidiary under the construction contract." Further, "qualified private companies" with "net worths" in excess of \$50,000,000 are exempt. The net worth must be calculated according to generally accepted accounting principles. The statute is silent as to how that net worth must be demonstrated-whether by letter, certificate, affidavit or declaration under penalty of perjury, or unqualified or qualified opinion—or by whom.

These exemptions, based on financial strength, are prejudicial to smaller owners and often unrelated to the alleged purpose of securing timely payment. Smaller owners with excellent payment histories will be burdened with additional costs, while qualified owners with bad payment histories can avoid Section 3110.5's compliance costs. An owner's good payment history, coupled with the traditional remedies, worked well for decades before Section 3110.5 became law.

Also, the vagueness of Section 3110.5 raises ambiguities that can only be resolved

by courts or legislative revisions. For example, Section 3110.5 exempts the single-family residence, which the section defines as a "dwelling unit for one family." But many condominiums are now detached single-family units. Counsel for detached single-family condominium projects should determine whether their clients' interests are best served by arguing for Section 3110.5 application or not. Moreover, the statute does not seem to prevent the owner who lacks sufficient bonding capacity from requiring a bond guarantee from the contractor. However, such an arrangement arguably would constitute an impermissible waiver of the statute. Further, the bond language requires payment if the owner is 30 days late, while there is no similar requirement for LOCs or escrow accounts. Perhaps this is an oversight that should be remedied by legislative amendment.

Owner's counsel have several options for dealing with Section 3110.5. First, owners can claim they are qualified companies. Second, owners can obtain guarantees from qualified parent companies. The third, and most common option, is for owners to do nothing, because the statute does not provide a penalty for noncompliance.

Noncompliance, however, is risky. Once the contractor serves a demand for security, it can stop all work if the security is not posted in 10 days. In addition, if a construction loan is obtained, ignoring Section 3110.5 may violate the lender's standard requirement that the borrower comply with all laws. Counsel for lenders and borrowers should negotiate a "stand by" bond, LOC, or escrow account that can be implemented within 10 days of a contractor's demand.

Senate Bill 800

Section 3110.5's attempt to provide a reliable mechanism for prompt payment to contractors may not be the remedy the construction industry hoped for, but its deficiencies probably will not, by themselves, stop owners and contractors from continuing to build projects in California. Indeed, payment issues are only one concern. Construction defect litigation, with its alarming scope and frequency, arguably eclipses payment issues as one of the greatest risks facing California's construction industry. The devastating costs of defect litigation puts a severe strain on the parties' resources, and they are among the reasons, along with the resulting repairs and insurance payouts, for the escalating prices and scarcity of new housing. In fact, construction defect litigation has severely limited the choices and options for construction insurance programs.

Hours before the close of the 2002 legislative session, the plaintiff's bar, contractors, developers, and lawmakers attempted to

address these problems as well as their varying interests by enacting a measure aimed to reduce construction defect litigation. 4 SB 800 sets forth the first statewide statutory scheme detailing what constitutes construction defects, warranties, repair obligations, and "prelitigation procedures" (further described as "nonadversarial" procedures)—all in an effort to settle defect disputes without litigation. Moreover, SB 800 attempts to provide flexibility so that builders arguably can modify the prelitigation procedures or warranty obligations and disclose these modifications to the buyers of a residential unit. In SB 800, the term "builder" does not include the contractor, subcontractors, and suppliers but, instead, is defined as the "builder, developer or original seller" of a residential unit.5

Prior to the enactment of SB 800, construction defect litigation was often initiated by counsel who first hired experts to find defects that allegedly caused economic losses to the project,6 then filed suit on behalf of homeowners under a strict liability theory and on a contingency fee basis. Typically, plaintiffs settled with the insurance companies for the value of the alleged defects, and from this amount the lawyer's contingent fee was paid. This common scenario sometimes left less money for repairs than was needed.

SB 800 provides a process for homeowners to receive either repairs or compensation for deficiencies in the construction, design, surveying, planning, supervision, or testing of their residential dwelling.7 First, SB 800 attempts to set standards for "every function or component of a structure" for which the builder, subcontractors, suppliers, manufacturers and designers can be found liable.8 These standards, commonly called functional

standards, address water barrier systems, structural systems, soil issues, fire protection systems, plumbing systems, electrical systems, manufactured items, hardscape, noise transmission, irrigation systems, untreated wood posts, untreated steel fences, paints, stains, landscaping, tiles, dryer ducts, structural safety, HVAC systems, fireplaces, chimneys, mechanical systems, retaining walls, stucco, exterior siding, shower and bath enclosures, foundations, decks, roofs, windows, doors, flashings, trim, and code compliance—and include a catch-all provision for all other unlisted components that cause damages. The builder must provide a one year "fit and finish" warranty and has the option of increasing the length and scope of the warranty by providing an "enhanced protection agreement" to homeowners at the time of sale.10

If a homeowner believes any functional standards were violated by the builder, the homeowner may assert claims under the warranty, enhanced protection agreement, or Chapter 4 of SB 800.11 To assert a claim under Chapter 4, the homeowner must comply with certain nonadversarial prelitigation procedures before commencing any construction defect litigation.¹² The builder must cooperate during the prelitigation procedures by, among other things, providing timely acknowledgment of the claims, and providing access to relevant plans, specifications, and other documents.¹³ The builder may elect to inspect the claims and make offers to repair or provide compensation for the alleged defects.¹⁴ The offer to repair must include an offer to mediate the claim. If the homeowner elects to mediate and the mediation proves unsuccessful in settling the claim, the homeowner must allow the builder to carry out the offered repair.¹⁵ If the builder fails to timely comply with any prelitigation procedure, or if the prelitigation procedures fail to settle the claim, subsequent litigation may still occur. 16

SB 800 attempts to forestall litigation pending the prelitigation procedures. Although the builder must deal directly with the claimant, the claimant's counsel must be copied on all communications.¹⁷ The prelitigation procedures require the builder to acknowledge the claim within 14 days and, if the builder elects to conduct an inspection, it must complete the inspection within 14 days after acknowledgment. If the builder deems that a second inspection is reasonably necessary, then a second inspection may be conducted within an additional 40 days. Within 30 days after the inspections are completed, the builder may offer to repair the problem and to pay certain limited damages to the claimant. Builder's counsel should ensure that the offer to repair contains the specific

800 Statutes of Limitations and

SB 800 provides a series of statutes of limitations that run from three possible dates: 1) the date the residential unit at issue is transferred to the homeowner, 2) the date of substantial completion, or 3) the date of occupancy of an adjacent unit when attached structures are involved.1 The length of the limitations period depends on which of the functional standards are at issue.

Most of the shorter statutes of limitations affecting claims by individual homeowners run from the date of the close of escrow, which could, in large projects, occur long after the date of substantial completion of the structure in which the unit is located. The functional standards contain numerous individual statutes of limitations ranging from one to 10 years for various building categories. Since many construction contracts have warranties that expire one year after substantial completion, many project builders-SB 800 uses the term "builder" to identify the "builder, developer or original seller" of a residential unit-may find themselves making repairs long after the warranties received from contractors, suppliers, and subcontractors have expired.

The statute of limitations period is extended during the SB 800 repair and mediation process. Once the process is completed, the claimant may sue, but the damages for construction defects will be limited if the repair has been performed properly. If the statute of limitations has run during the prelitigation procedures, the statute "is extended from the time of the original claim by the claimant to 100 days after the repair is complete, whether or not the particular violation is the one being repaired."2

If the builder makes an offer to repair, the homeowner has 30 days within which to make an election to accept the offer, to request the names of three alternate contractors to perform the repair, or to request mediation. Mediation must proceed within 14 days after it is requested. The mediator is chosen by and paid for by the builder unless both parties elect to choose and pay for the mediator. The mediation is limited to four hours unless mutually extended by the parties. At the end of the mediation, the parties either agree on a resolution or the claimant must allow the offered repair to be performed. Repairs must proceed with "utmost diligence," must commence within the time periods stated in Civil Code Section 921, and "every effort" must be taken to complete a repair within 120 days of the homeowner's acceptance of the offer to repair.-B.C.J.

¹ See Civ. Code §§895(e), 896(e), 896(g)(6), 941.

² CIV. CODE §927.



information required concerning the scope, timing, and implementation of the proposed repair, including the name of the contractors whom the builder would like to perform the repair.18

With all its prelitigation procedures, SB 800 does not appear to offer sufficient incentives to settle construction defect claims without subsequent litigation. Also, SB 800 may spur litigation that secures less money than is needed for all the repairs. Indeed, if the SB 800 prelitigation procedures fail, other SB 800 provisions may increase the likelihood of litigation:

- The detailed functional standards make it easier for claimants to allege a list of building deficiencies that are deemed to be construction defects by statute. Prior to SB 800, claimants had the burden of establishing that certain deficiencies in construction rose to the level of a construction defect that violated the standard of care in the industry.
- Once defects are alleged, builders and contractors must immediately produce a host of documents19 without the expensive and time-consuming discovery procedures common in all other civil litigation. The claimant's reduced discovery costs and the less time required for the production of documents make litigation a less costly and more attractive option.20
- Builders must inspect and provide repairs within nearly impossible time periods, which increases the likelihood of a technical failure to comply with the builder's prelitigation duties and opens the way for claimants to commence litigation.
- Homeowners are prohibited from releasing their claims in exchange for repairs,21 which subjects builders to certain litigation.

 Attorney's fees may be awarded to the claimant if the builder is unsuccessful in staying litigation brought by a claimant who did not complete the prelitigation procedures.²² This can occur if the builder fails to meet any of its prelitigation duties within the specified time limits, thereby allowing a claimant to bring litigation before exhausting the prelitigation procedures.

However, builders received a few potential benefits under SB 800. The statute of limitations for certain functional standards was reduced from 10 years to shorter periods, although the catch-all provision arguably allows for the full 10-year statute of limitations to apply to all functional standards not specifically listed in SB 800.²³ When the repair is completed, if no prior mediation occurred, mediation must commence before filing an action.²⁴ A builder can cite repairs as defenses in subsequent litigation.²⁵ Finally, if a cash settlement is provided, the builder can obtain a release from the homeowners—but a repair on its own cannot result in a release.26

The builder also must compensate the claimant for all damages resulting from the repair. Alternatively, the builder may elect to repair some but not all of the alleged defects, allowing the unrepaired alleged defects to be litigated. SB 800 repair damages are limited to the reasonable value of repairing any violation of the functional standards, any damages caused by the repairs, the cost of removing and replacing an improper repair by the builder, reasonable relocation and storage expenses, lost business income if the home is licensed to be used as the principal place of business, reasonable investigative costs, and all other costs or fees recoverable by contract or statute.27 Under SB 800 the home-

owner can pick one of three contractors presented for repairs, which may raise concerns if the original subcontractor is not picked to perform the repairs. Under most form contracts, the original contractor generally has a right to repair defective work for a period of one year after substantial completion or the builder may have waived its claims for breach of warranty against the original contractor.²⁸

Builder's counsel should advise the builder to "buy down" any high contractor or designer insurance deductibles and hire only economically strong subcontractors to facilitate repairs by the original subcontractor or other subcontractor elected by the homeowner. Further, counsel should recommend that the builder offer the homeowner an enhanced protection agreement29 under SB 800 that can be structured to provide timely repairs of any functional standards for a number of years rather than the one-year warranty for fit and finishes typically provided by builders. Such an enhanced protection agreement should make it easier for the homeowner to seek defect remedies through the enhanced protection agreement rather than by asserting a prelitigation procedure claim followed by litigation. Further, this strategy helps avoid the expensive prelitigation option of the homeowner choosing someone other than the builder and its contractors for carrying out the repairs. However, such enhanced warranty programs "may not limit...or lower" the protections provided in the functional standards or one-year warranty.30

To cure the insurance deficiencies and excessive deductibles, counsel may suggest project-specific "wrap" policies that can be designed to provide coverage for worker's compensation, commercial general liability, professional liability, automotive liability, excess umbrella coverage, builder's risk, and other types of coverage all controlled by either the owner or the contractor to ensure payment of premiums, claims control, and reasonable rates through greater purchasing power. These wrap policies are often called Owner Controlled Insurance Programs (OCIPs) or Contractor Controlled Insurance Programs (CCIP), depending on who is providing the wrap. In today's insurance markets, wraps often are the only source of condominium project-specific insurance with adequate levels of coverage, reasonable deductibles, and related terms.

Another vexing issue arises when claimants are homeowner's associations. Claims from associations are not only subject to SB 800 but also the "Calderon Process."31 Under Calderon, the association must serve the builder or contractor with notice of litigation that lists the defects, the extent of the defects, and a summary of any tests. This

notice starts a 180-day dispute resolution period during which documents are produced, case management plans are agreed upon, inspections and testing are conducted, other contractors and designers are joined, insurance carriers are notified, settlement negotiations occur, document depositories are established, and discovery references are appointed. If the claims are not settled during the 180-day period, a complaint may be filed with trial priority.32 Compliance with Calderon arguably is excused if SB 800 is enforced in a manner substantially similar to Calderon.33

However, in some respects, SB 800 and Calderon appear at odds with each other. For example, the Calderon Process takes a minimum of six months before litigation commences, while the SB 800 prelitigation procedures are often completed in half that time. Also, Calderon generally leads to a liquidated settlement amount without repairs, while SB 800 requires repairs, payments, or mediation. Many wonder how a builder is supposed to satisfy these opposing interests. It generally appears advantageous to utilize SB 800 in order to be "excused from performing the substantially similar requirements [of Calderon]."34

Builder's counsel should consider opting out of the SB 800 prelitigation procedures by utilizing alternative contractual procedures before any sales take place.35 If the builder elects to opt out, then the election is binding, even if the alternative contractual procedures are not successful or are held to be unenforceable.³⁶ If an opt out provision is struck down, the claimant will be able to sue without affording the builder a right to repair or mediate. In opting out, a builder might want to simplify the repair process, impose more control on the selection of the contractor, and modify time periods. However, since there is no safe harbor for opting out of the prelitigation procedures, and since a judge or arbitrator may invalidate the opt out provision and allow the plaintiff to proceed directly to litigation or arbitration, many builders choose not to opt out of the SB 800 prelitigation procedures. Rather than the all-or-nothing crap shoot of opting out, many builders are attempting to avoid utilizing the SB 800 prelitigation procedures by providing an enhanced protection agreement.

After the nonadversarial prelitigation procedures or alternative contractual procedures are completed, SB 800 generally allows the claimant to proceed to litigation. However, Civil Code Section 914(b) also states that "nothing in this title is intended to affect the applicability, viability, or enforceability, if any, of contractual arbitration or judicial reference after a nonadversarial procedure or provision

has been completed."

Thus some builders are requiring arbitration or judicial reference in lieu of litigation after the nonadversarial prelitigation procedures are completed. However, mindful of the recent case of Pardee Construction Company v. Superior Court (Rodriguez), builders requiring arbitration or judicial reference must do so in strict accordance with other statutory requirements in order to avoid claims of unconscionability, duress, and adhesion.37 Further, Code of Civil Procedure Section 1298.7 precludes binding arbitration in real estate contracts involving construction defects. However, the recent appellate case of Basura v. United States Home Corporation found that the Federal Arbitration Act preempted Section 1298.7 and upheld the arbitration clause as "valid, irrevocable and enforceable, save upon ground such as exists at law or in equity for the revocation of any contract."38 Therefore, under Basura, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements."39

With Pardee and Basura in mind, builder's counsel hoping to utilize arbitration or judicial reference after the prelitigation procedures of SB 800 must carefully follow the procedures outlined in Section 1298.7. Builders may avoid

arguments of adhesion and unconscionability⁴⁰ by offering the purchaser the choice of arbitration, judicial reference, or litigation along with a detailed description of the pros and cons of each choice in lay terms. Such choices should avoid a waiver of punitive damages or the right to a jury trial, since those types of waivers also were found to be unconscionable in Pardee. Finally, counsel might suggest that the builder pay for all arbitration or judicial reference procedures, thereby countering the *Pardee* argument that the homeowners did not understand the economic burdens of judicial reference or arbitration.

Contractor License Law Compliance

If SB 800 and Section 3110.5 were not enough for counsel to master, many owner's counsel are unknowingly allowing their clients to violate California's contractor license laws. The license laws require those who perform any aspect of construction work—including owners—to be properly licensed as contractors at all times, or else they cannot "bring or maintain" an action for payment. Specifically, unlicensed owners are in danger of losing all compensation for developing their property for third-party purchasers. Owner's counsel

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PACIFIC HEALTH & SAFETY CONSULTING, INC. 2192 Martin, Suite 230, Irvine CA 92612 must carefully review the structure of each project to avoid such license law violations.

For example, unlicensed owners often are retained to not only sell their property to a buyer but also construct a building on the property that meets the buyer's specifications. In such a "build-to-suit" scenario, the owner is providing contracting and construction oversight for the buyer, and this requires a contractor's license-even if a licensed contractor is hired by the owner to perform all the construction work.41 If the owner is developing the project for its own portfolio and has no current intention of selling the project (as evidenced by the owner holding the project without intention to sell for at least a year), then the owner may take advantage of the "owner/builder" exemption to the contractor license laws.⁴² Without an exemption, even well after the project is sold, the buyer may sue the developer for disgorgement of its build-to-suit fees because the owner failed to obtain a contractor's license.43

Crisis Management Plans

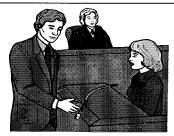
In addition to Section 3110.5, SB 800, and contractor licensing requirements, counsel should advise their construction industry clients regarding other possible threats to their projects, including terrorism, environmental activism, and natural disaster. Recently, several upscale houses and an apartment complex in the San Diego area were destroyed by fires allegedly set by environmental activists.44 The damages were estimated at \$50 million.45 Also, late last year arson allegedly started the most destructive fire season in California history, resulting in the loss of over 3,500 homes, more than 20 lives, 46 and \$3 billion in damages. 47 These and other catastrophic events should alert owners and contractors to establish a crisis plan as a means to protect their investments and reputations. The overall objective of the crisis plan should be to save lives, save property, assist public rescue forces, disseminate information to the press and the public, and streamline the process of getting a project back on track as quickly as possible.

Crisis plans often fail because they do not envision all the potential risks that might impact a project. At a minimum, counsel should start with the foreseeable risk and then involve consultants and members of the company to edit, augment, and adapt the list of risks to a particular project.

Counsel should evaluate sources of supplies, equipment and fuel, and vulnerable supply routes. For example, owners and contractors should consider choosing a supplier or subcontractor that has its own secure yard with materials, fuel, and equipment instead of

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relying on suppliers or subcontractors who obtain these items from sources or supply routes that may be interrupted by civil wars or terrorism. Further, counsel should negotiate contractual arrangements with local supply sources to reserve local stocks for their projects instead of other projects, even if a premium is charged for such arrangements.

The list of typical risks should include: 1) terrorism, 2) war, 3) violence, 4) vandalism, 5) labor unrest, 6) fire, 7) explosion, 8) extreme weather, including high winds, electrical storms, or flooding, 9) earthquake, 10) slope failures, 11) structural collapse, 12) drought, 13) equipment accidents, and 14) environmental activism.

When death or injury takes place on a project, litigation counsel should be retained immediately. OSHA must investigate all injuries or deaths. Counsel should retain independent consultants to preserve evidence and evaluate the causes of various injuries or damages. Expert reports can be kept confidential, if necessary, under the attorney work-product doctrine if the experts are retained by counsel.

Quickly gathering and disseminating information is critical for successful crisis management. Public relations personnel should coordinate with counsel to disseminate meaningful information in a professional way that also protects the clients' interests. Drafts of prepared text should be included in the crisis plan so that the designated spokespersons can have a ready framework for organizing information and communicating effectively in times of extreme stress. These drafts help avoid inadvertent and inaccurate admissions of liability.

Placing the project back on track is the final task. Counsel should obtain photographs, videos, and reports by reliable experts in order to pursue insurance and public agency funds. Consultants may be necessary to evaluate site safety, security breaches, and related measures before construction resumes.

The construction industry faces numerous challenges adapting to Civil Code Section 3110.5, SB 800, and contractor licensing requirements. During the current challenging economy, the added cost and necessity of securing the owner's payment obligations under Section 3110.5 require careful representation and artful negotiations by counsel. Perhaps lawmakers should conduct a careful reevaluation of the traditional remedies that protect contractor payments rather than impose the Section 3110.5 mechanisms. Further, SB 800 has so far failed to persuade insurance companies to lower their construction defect premiums. Despite the prelitigation procedures in SB 800 to settle defect claims through the repair process, the finan-

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cial motivations to litigate these claims remain. Also, owners must obtain contractor's licenses when necessary to avoid losing all their fees when they knowingly or unknowingly cross the line and provide services that require a contractor's license.

Counsel must be adept at identifying issues of liability before their clients face indefensible legal exposure. In addition, counsel should help their clients draft crisis management plans that create ways to minimize liability and loss caused by natural disasters and terrorism.

- ¹ See William R. Clarke Corp. v. Safeco Ins. Co., 15 Cal. 4th 882 (1997), and Capitol Steel Fabricators, Inc. v. Mega Constr. Co., Inc., 58 Cal. App. 4th 1049 (1997). The Legislative Analysis for §3110.5 states that the bill was proposed in response to these two 1997 decisions. ² Civil Code §3260.2, enacted in 1998, was another legislative response to Safeco, Safeco, 15 Cal. 4th 882. Civil Code §3260.2 allows contractors to stop work upon 10days' notice for nonpayment of undisputed amounts by the owner. Essentially, §3260.2 provides stop work remedies similar to §3110.5 without the added teeth of costly bond, LOC, or escrow requirements.
- 3 By its terms, §3110.5 applies to construction, alterations, or repairs on real property.
- 4 CIV. CODE §§895-945.5.
- 5 See Civ. Code §911. See also Civ. Code §919 (A repair is "to be performed either by the builder, its contractor, or the selected contractor.") and Civ. Code $\S\S1375(p)$ (2), 1351(g) (A "builder" is defined as the "persons or group of persons who sign the original declaration" setting

forth the Covenants Conditions & Restrictions (CC&Rs) for a common interest development.).

- ⁶ See Aas v. Superior Court, 24 Cal. 4th 627 (2000), and Jimenez v. Superior Court (T. M. Cobb Co.), 9 Cal. 4th 473 (2002). Essentially, Aas barred recovery for construction defects except when the defects cause "economic losses." However, Jimenez held that the economic loss doctrine of Aas did not bar the strict products liability imposed on manufacturers of mass-produced items installed in residential projects if those items cause damage to other construction elements in the projects. See also CIV. CODE §897.
- ⁷ See Civ. Code §§895-896.
- 8 See CIV. CODE §§896-897.
- ⁹ *Id*.
- 10 See Civ. Code §§900-906.
- $^{\rm 11}$ Id. See also Civ. Code §§910-938.
- ¹² See Civ. Code §910.
- 13 See CIV. CODE §§910-938.
- ¹⁴ See Civ. Code §§916-917.
- ¹⁵ See Civ. Code §919.
- 16 See Civ. Code §915.
- ¹⁷ CIV. CODE §913.
- ¹⁸ CIV. CODE §§916-917.
- 19 See Civ. Code $\S 912.$
- ²⁰ See Code Civ. Proc. §§2016-2036.
- ²¹ See Civ. Code §§926, 929.
- ²² CIV. CODE §930(b).
- ²³ CIV. CODE §§897, 941.
- ²⁴ CIV. CODE §928.
- ²⁵ CIV. CODE §945.5.
- ²⁶ CIV. CODE §§926, 929.
- ²⁷ CIV. CODE §944.
- 28 See AIA General Conditions for the Contract of Construction A201-1997, §12.2.2.1.
- ²⁹ CIV. CODE §§901 et seq.
- 30 CIV. CODE §§901, 903.

- 31 CIV. CODE §§1375 et seq.
- 33 CIV. CODE §935.
- ³⁴ *Id*.
- 35 Civ. Code §914.
- 36 *Id*.
- 37 Pardee Constr. Co. v. Superior Court (Rodriguez), 100 Cal. App. 4th 1081 (2002). Pardee held that clauses for judicial reference and for waiver of punitive damages were unenforceable because the underlying purchase and sale agreement was an agreement of adhesion and the clauses were unconscionable.
- 38 Basura v. U.S. Home Corp., 98 Cal. App. 4th 1205, 1212 (2002). Basura held that the Federal Arbitration Act preempted Code of Civil Procedure §1298.7 because the project utilized manufactured goods and communications that involved interstate commerce, and there were no contravening contract defenses—such as fraud, duress, unconscionability, or adhesion-that would invalidate the arbitration agreement.
- 39 Id.
- 40 See also Villa Milano Homeowners Ass'n v. Il Davorge, 84 Cal. App. 4th 819 (2000) (holding that contract provisions in CC&Rs requiring arbitration were both procedurally and substantively unconscionable).
- 41 See Bus. & Prof. Code §§143, 7031(b), 7026, 7028, 7029, 7031; see also Ranchwood Cmtys. Ltd. P'ship v. Jim Beat Constr. Co., 49 Cal. App. 4th 1397 (1996).
- 42 Bus. & Prof. Code §7044.
- 43 Bus. & Prof. Code §7031(b).
- 44 Tony Perry & Jie-Rui Chong, Six Houses Torched in Protest Act, L.A. TIMES, Sept. 20, 2003, at B1.
- 45 Id.
- 46 Ron Harris, Lack of Workers May Delay Fire Rebuilding, L.A. TIMES, Nov. 9, 2003, at K4.
- ⁴⁷ Kenneth Reich, The State, Fire Insurance Payouts Could Reach \$3 Billion, L.A. TIMES, Nov. 18, 2003, at B6.

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