



## NEWS IN BRIEF

SEPTEMBER 2003 VOLUME 7, ISSUE 2

## CAN YOU RESCIND YOUR CONTRACT?

### Greetings from the Editor

As you read this issue, we are mired in thick construction dust during the renovation and expansion of our offices. Those of you in the construction business probably laugh as you read this and think it's about time we lawyers experience first hand what you live from day to day. We are adding to our premises to provide better space for our new professionals — in the last twelve months we have grown to sixteen lawyers, three paralegals, and a support staff of twelve. Please drop by in October and visit our new space. —Cathy Fisher ❖

### In this issue:

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- Court Rules that Homeowners Association Has Privity to Sue a Developer/Builder for Breach of Implied Warranty
- Liability of Public Entities Under the False Claims Act
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- BR&H Breakfast Forum Wednesday, September 24 (see page 4)

**HAVE YOU EVER HEARD (OR SAID) THIS?** “I have a check for you, and just take it or leave it, this is all you get. If you don't want this, you have got to sue me.” Receipt of the check, of course, is conditioned on signing an unconditional waiver of your contract and mechanic's lien rights. The subcontractor in the case quoted above successfully had the court set aside the release and received the rest of the money due him. The court held that the contractor's unwarranted refusal to pay, coupled with his knowledge that the subcontractor was operating on a tight margin, constituted economic duress that justified setting aside, or rescinding, the release.

### *The Concept of Rescission*

Rescission is a remedy that is often overlooked in contract disputes. Rescission is essentially the act of returning the parties to their positions before the contract existed. In its simplest form, a buyer gives back the goods and the seller gives back the money. In construction cases where the work has been performed, the contract is void and the contractor is paid on a quantum meruit or time-and-materials basis.

The California Civil Code says that a party to a contract may rescind it under specified circumstances including a situation where “the consent of the party rescinding . . . was given by mistake, or obtained through duress, menace, fraud, or undue influence . . .” Civil Code § 1689. Rescission based on mistake, duress, or fraud rests on the fundamental principle that there must be mutual consent of the parties for a contract to exist. The presence of mistake or fraud, or the lack of free will created by duress, vitiates one party's ability to consent and provides a basis for the contract to be voided.

Mistake sufficient to void a contract can be a mistake of fact or law, and can be unilateral or bilateral. Mistake of fact, for example, may occur when both parties believe a certain condition exists that does not. In *Johnson v. Withers* (1908) 9 Cal.App. 52, both parties to a contract for the purchase of land relied on the statement of an expert as to the amount of a mineral present. When the purchaser discovered that the quantity was ten times less, he sought, and the court ordered, rescission of the contract and the return of his money. Unilateral mistake, which is a variety of fraud, is the basis for rescission when one party knows that the other

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## CAN YOU RESCIND YOUR CONTRACT?

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is operating under a mistake of fact in signing a contract and does not disclose the true facts.

In the construction industry, rescission can be based on any of the grounds in the Civil Code, but the nature of the industry creates a very real possibility of duress when contractors are negotiating change orders or final payment.

### **Rescission Based on Economic Duress**

The concept underlying economic duress is that one party cannot use threats of illegal action to force another party to do something. Recent cases hold that economic duress consists of “the doing of a wrongful act which is sufficiently coercive to cause a reasonably prudent person faced with no reasonable alternative than to succumb to the perpetrator’s pressure.” Thus, the legal elements that a contractor must prove to show duress are: (1) a wrongful act by the owner; and (2) no reasonable alternative for contractor. The assertions of a knowingly false claim or a bad faith threat to breach or to withhold payment are wrongful acts.

In *Leeper v. Beltrami* (1959) 53 Cal.2d 195, the California Supreme Court held that a threat to business or property interests constitutes duress. In that case, the plaintiff pleaded that she was compelled to pay a debt already satisfied in order to preclude foreclosure on their mortgage. Defendants argued that, because foreclosure is a legal remedy, the threat could not constitute duress. The court disagreed, because the plaintiff pleaded that the defendants knew the claim was false. As the court said, “[t]he entire conduct reeks of fraud. The very press-

ing of a false claim with knowledge of its falsity constitutes misrepresentation, which is the backbone of what we know as ordinary fraud.” *Id.* at 207–208.

The *Leeper* defendants also argued that, instead of paying the money they demanded, the plaintiff could have allowed her home to be sold and then contested the foreclosure. The court’s response was that, “[t]o allow one’s home to be sold at a foreclosure sale is not a reasonable alternative. A reasonably prudent person would not take such a course. This is the test.” *Id.* At 205.

In *Rich & Willock, Inc. v. Ashton Development, Inc.* (1984) 157 Cal.App.3d 1154, 1158, the case quoted in the introduction, a subcontractor submitted a final billing for \$72,286.45 and the contractor refused to pay, contending that it was short on funds. The subcontractor told the contractor that it would go broke if it weren’t paid. The contractor then said it would pay \$50,000. When the contractor provided the subcontractor with a release and a check, however, it was for \$25,000 with a promise to pay an additional \$25,000 in a month. The subcontractor signed, telling the contractor it was “blackmail.” After receiving the second payment of \$25,000, the subcontractor sued for the balance of the final payment. The trial court threw out the settlement and the Court of Appeal agreed; it cited the contractor’s actions as being in bad faith and coercive.

The court in *Rich & Willock* stated that defendants’ knowledge of the plaintiff’s economic condition, and plaintiff’s statement that its distressed financial position was the reason for its capitulation, were evidence of circumstances supporting a claim of economic duress. It is

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important to note, however, that such findings were not held to be a prerequisite to a finding of economic duress; it was only one factor. Thus, a court might find duress even where the victim was not under financial stress. The question is whether the party seeking rescission and claiming duress had a reasonable alternative.

When a party pleads economic duress, that party must have had “no reasonable alternative” to the action it seeks to avoid. If a reasonable alternative was available, there was no compelling necessity to submit to the coercive demands and economic duress cannot be established. *CrossTalk Productions, Inc. v. Jacobson* (1998) 65 Cal.App.4th 631, 644. Whether the party asserting economic duress had a reasonable alternative is determined by examining whether a reasonably prudent person would follow the alternative course, or whether a reasonably prudent person might submit. *Louisville Title Ins. Co. v. Surety Title & Guar. Co.* (1976) 60 Cal.App.3d 781, 802.

### **Threats of False Claim Actions as Economic Duress**

There is a perception in the construction industry that public entities are increasingly using the threat of an action under the False Claims Act against contractors to obtain an advantage in claims litigation. While there are no reported cases citing duress as a defense to this tactic, if a public entity were to threaten a false claim action knowing that there was no basis for it, it could constitute duress.

There is case law supporting rescission of a non-

construction contract with a public entity based on economic duress. In *Short Line Associates v. City and County of San Francisco* (1978) 78 Cal.App.3d 50, the Court of Appeal found that the City and County of San Francisco had wrongfully forced a property owner to pay for an easement and rescinded the easement agreement. The act constituted economic duress because the City refused to grant the plaintiff a construction permit unless it purchased the easement. The Court found that the City’s insistence on the easement was unjustified because the plaintiff already had rights to ingress and egress, and for light and air over the public property involved.

“Since plaintiffs were deprived of their right to construct the building unless they purchased the easement, the contract for the easement was entered into under conditions of economic duress.” *Id.* at 59.

Under the theory of economic duress, therefore, it may be possible to have a settlement or other compromise of claim with a public entity rescinded if it was the result of the public entity threatening an unfounded false claim action.

### **Conclusion**

It may be possible to have certain releases, change orders, or other forms of compromise rescinded based on economic duress, but prevention is always better. If you believe that another party is coercing you, seek legal assistance. Even if you are forced into a compromise, the involvement of counsel may well lead to the documentation and other evidence necessary to later prove your case.

—Teresa Jenkins Main ❖

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**BR&H Breakfast Forum**  
*welcomes*

**John Russo**  
*Oakland City Attorney*

BELL, ROSENBERG & HUGHES LLP is pleased to announce **John Russo** as the guest speaker at our popular BR&H Breakfast Forum. Mr. Russo will speak on *The California Budget Fiasco: How did this happen? What are the real stakes?*

John Russo is Oakland's first elected City Attorney. He is President of the League of California Cities and he serves on the National League of Cities' Public Safety Committee. To learn more about John Russo and the Oakland City Attorney's Office, visit [www.oaklandcityattorney.org](http://www.oaklandcityattorney.org).

DATE: Wednesday, September 24, 2003  
TIME: 7:30 A.M. Continental Breakfast  
8:00 A.M. Presentation  
LOCATION: Waterfront Plaza Hotel, Spinnaker I Room  
10 Washington Street, Oakland  
(at Jack London Square)

**RSVP**

Sheila Garvey  
(510) 839-6925 (fax)  
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skg@brhlaw.com (email)

**Please note**

the new Breakfast Forum location!  
For directions, maps, and more information  
about the venue, please go to  
[www.waterfrontplaza.com](http://www.waterfrontplaza.com)

**Faxable RSVP form:** Yes, I will attend! \_\_\_\_ Total number of attendees \_\_\_\_

Name(s) \_\_\_\_\_

Company \_\_\_\_\_

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## ***COURT RULES THAT HOMEOWNERS ASSOCIATION HAS PRIVACY TO SUE A DEVELOPER/BUILDER FOR BREACH OF IMPLIED WARRANTY***

In *Windham at Carmel Mountain Ranch Association v. Superior Court* (June 17, 2003) 109 Cal.App.4th 1162, the California Court of Appeal ruled that a homeowners association has standing to sue a builder of condominiums for breach of implied warranty, and rejected the builder's contention that the homeowners association lacked the necessary privity of contract with the builder to maintain a cause of action.

The builder had designed, developed, constructed, marketed, and sold 120 residential condominiums. The builder also formed the homeowners association to manage, maintain, and repair the condominiums' common areas, and filed a declaration of covenants, conditions, and restrictions granting the homeowners' association the ability to do so. The homeowners association and an individual owner of a condominium filed suit against the builder, alleging, among other causes of action, breach of implied warranty. The complaint alleged numerous defects that breached this implied warranty and alleged that those defects caused property damage, endangered the health and safety of the residents, and interfered with the owners' use and enjoyment of the property.

The builder demurred to the complaint, alleging that the complaint did not contain facts showing that the homeowners association had privity of contract with the builder and was thus unable to maintain a cause of action for breach of implied warranty. When the homeowners association opposed the demurrer, arguing that Code of Civil Procedure § 383 granted it privity of contract, the builder replied that § 383 only applies to tort causes of action for defective construction and that breach of an implied warranty is a contract cause of action. The trial court agreed with the builder and granted its demurrer without leave to amend.

The Court of Appeal reversed the trial court. While affirming that privity of contract was required to maintain an action for breach of implied warranty, the Court ruled that § 383 provides the homeowners association with that privity:

"An association established to manage a common interest development shall have standing to institute . . . litigation . . . in its own name as the real party in interest and without joining with it the individual owners of the common interest development, in matters pertaining to . . . damage to the common areas." Code of Civil Procedure § 383.

After reviewing the rules of statutory construction and the statute's apparent purpose and public policy considerations, the Court held that § 383 expressly grants homeowners associations standing to sue in their own name as the real party in interest for damage to common areas, including a cause of action based on breach of warranty. The Court ruled that, because § 383 grants the ability to sue for breach of warranty, its plain meaning necessarily includes the grant to associations of status as parties with the requisite privity of contract.

In reaching its ruling, the Court considered a variety of arguments put forth by the builder. First, the builder argued the reference to "damage" in § 383 necessarily implied only that tort causes of action were within the scope of § 383. The Court rejected the builder's definition of "damage," noting that it included harm, loss, injury, detriment, or diminution of value and that it could be caused by any breach of duty arising under contract, tort, or implied warranty.

Second, the builder argued that if the Court ruled that the homeowners association possessed privity to state a breach-of-implied-warranty cause of action, then the owners would be deprived of their individual privity of contract and ability to maintain their own lawsuits against the builder. The Court also rejected this argument, stating that privity was not a transfer of an interest but a relationship that the legislature had deemed the homeowners association possessed. The Court stated that an individual owner was not deprived of his or her own contractual privity and could maintain an individual cause of action against

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the builder for breach of implied warranty regardless of the homeowners association's action.

Finally, the Court rejected the builder's contention that the Court's ruling would circumvent *Aas v. Superior Court*. *Aas* concluded that homeowners and homeowners associations may not recover damages in negligence from the developer, contractor, or subcontractor who builds their dwellings for construction defects that have not caused property damage; the *Aas* Court noted that other causes of action, including breach of contract and breach of warranty, remained available for recovery of those types of damages.

— Christian A. Carrillo ❖

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## LIABILITY OF PUBLIC ENTITIES UNDER THE FALSE CLAIMS ACT

Over the last three years, the liability of states, municipalities, and government agencies for damages under the False Claims Act has been a topic of two seminal Supreme Court decisions. While the holdings of these two decisions are consistent, dicta within them conflict over the nature of statutory damages for false claims.

### **Liability for the State and State Agencies.**

In *Vermont Agency of Natural Resources v. United States, ex rel. Stevens* (2000) 529 U.S. 765, the United States Supreme Court considered the question of whether a state, or a state agency, could be subject to liability under the False Claims Act. The opinion of the Court, delivered by Justice Scalia, was that the False Claims Act did not subject a state, or state agency, to liability in such actions.

In *ex rel. Stevens*, Mr. Stevens sued his former employer, the Vermont Agency of Natural Resources, under

the False Claims Act, alleging that in order to boost grant funding, the Agency had submitted false claims to the government by overstating the time spent by employees. On appeal from the Second Circuit, the Court first determined that Stevens had standing to bring the *qui tam* action, and then considered whether the state was a "person" under the False Claims Act.

Under the Supreme Court's long-standing interpretive presumption, the word "person" does not include the sovereign, in this case, the State of Vermont. See, e.g., *United States v. Cooper* (1941) 312 U.S. 600. While this presumption was not a "hard and fast rule," it may only be disregarded upon affirmative showing of a statutory intent to the contrary. See *International Primate Protection League v. Administrators of Tulane Ed. Fund* (1991) 500 U.S. 71. After examining the history of the original False Claims Act, as well as its subsequent amendments, the Court concluded that far from providing an indication that the term "person" included states for purposes of false claims liability, the historical evidence indicated "quite the contrary" and that nothing suggested a broadening of the term "persons" to include the States.

Furthermore, while not essential to the holding, the Court suggested that false-claims damages could be considered punitive and states would thus be immune to such suits. The Court noted that the current version of the False Claims Act imposes treble damages and a civil penalty of up to \$10,000 per claim and stated that such damages "are essentially punitive in nature [and] inconsistent with . . . the presumption against imposition of punitive damages on governmental agencies." *Id.* at 784.

Given these considerations and the absence of Congress's express intent to alter the usual constitutional balance between the states and the federal government, the Court held that a state or a state agency was not subject to liability under the False Claims Act. See also *United States, et al. v. Regents* (9<sup>th</sup> Cir. 2003) 03 C.D.O.S. 4242 (holding that the University of California, as a state agency, was exempt from liability under the False Claims Act). The Court declined to rule whether the False Claims Act "would run afoul" of the Eleventh Amendment but noted that there was "serious doubt on that score." *Id.* at 784.

### **Liability for Municipal Governments.**

Almost three years after its decision in *Stevens*, the United States Supreme Court revisited the issue of false claims liability for public entities. In *Cook County v. United States, ex rel Chandler* (2003) 123 S.Ct. 1239, the Court held that local governments are subject to liability under the False Claims Act.

Writing for a unanimous Court, Justice Souter examined the history of the definition of "person." Justice Souter noted that, since 1826, the Court recognized that the definition of "person" includes "persons politic and incorporate." See *United States v. Amedy* (1826) 24 U.S. 392 (quoting 2 E. Coke, *Institutes of the Laws of England* 736 (1787 ed.)). This was common understanding when the original False Claims Act was passed in 1863. Six years later, the decision in *Cowles v. Mercer County* (1869) 74 U.S. 118 was a "natural recognition . . . that municipal corporations and private ones were simply two species of 'body politic and corporate,' treated alike in terms of their legal status as persons capable of suing and being sued." The Court concluded that nothing in the subsequent history of the False Claims Act warranted excluding municipalities from the class of "persons" covered by the False Claims Act.

The Court rejected Cook County's contention that the False Claims Act of 1986 repealed municipal liability by raising the damages recoverable from double to treble, which, according to the County, constituted punitive damages against a public entity. The Court stated that this threefold multiplier of damages has a compensatory function to compensate the government for the loss of the recovery that may go to a private person who began the action. In addition, the Court ruled that liability beyond actual damages might be necessary for full recovery, as the False Claims Act makes no provision for recovery of prejudgment interest or of consequential damages. Further, the Court ruled that treble damages do not equate with "classic" punitive damages, which leaves the jury with open-ended discretion over the damages amount. Finally, in rejecting the argument that the 1986 amendment repealed municipal liability, the Court adhered to the "cardinal rule . . . that repeals by implication are

disfavored." See *Posadas v. National City Bank* (1936) 296 U.S. 497. In the absence of Congress's express intent to repeal municipal liability, the Court held that local municipalities are liable under the False Claims Act.

### **Conflict Over the Nature of False Claims Damages.**

The Court has recognized a bright line difference between liability for the state and its agencies and liability for municipal governments and its agencies. Buried in these two opinions, however, are conflicting views over the nature of the damages prescribed by the False Claims Act. *Stevens* called the damages essentially punitive in nature while *Chandler* rejected this view and went to great lengths to demonstrate the differences between damages under the False Claims Act and "classic punitive damages." This conflict may provide the basis for a more adventurous court to strike down liability under the False Claims Act for municipal entities.

—Christian A. Carrillo ❖

## COURT WATCH

**LATENT DEFECTS AND  
EQUITABLE TOLLING****Equitable Tolling Does Not Apply to the 10-Year  
Statute of Limitations for Latent Construction Defects**

Plaintiffs filed a complaint for damages caused by design or manufacturing defects in their houses. Although the complaint was filed after the 10-year statute of limitations for latent defects had expired, plaintiffs claimed that the doctrine of equitable tolling should apply because defendants attempted to make repairs at various times. Defendants demurred to the complaint on grounds that the entire action was barred by the 10-year limitations period. The trial court sustained the demurrer on statute of limitations grounds. The Court of Appeal reversed based on *Grange Debris Box & Wrecking Co. v. Superior Court* (1993) 16 Cal.App.4th 1349 and *Cascade Gardens Homeowners Assn. v. McKellar & Assoc.* (1987) 194 Cal.App.3d 1252, which extended application of equitable tolling for repairs to California Code of Civil Procedure § 337.15's 10-year statute of limitations. The California Supreme Court reversed the Court of Appeal's judgment and held that equitable tolling does not apply to the 10-year statute of limitations. The Court also disapproved *Cascade Gardens* and *Grange Debris* to the extent those cases conclude that equitable tolling applies to the 10-year statute. The Court reasoned that a broad equitable tolling rule for repairs would be contrary to the language of the statute and the Legislature's intent to ensure a generous but firm cutoff date for latent-defect suits. The Court also reasoned that the "extraordinary length" of the limitations period weighs against the need for an equitable-tolling-for-repairs rule as a matter of fair procedure. The Court considered that the purpose of the statute was to protect contractors and other professionals and tradespeople in the construction industry from perpetual exposure to

liability for their work. The Court, however, left open the possibility that one potentially liable for a construction defect could be equitably estopped to assert the statute of limitations as a defense to the action, but it found that the complaint in this case did not adequately plead equitable estoppel. *Lantzy v. Centex Homes* (August 4, 2003) 2003 Cal. LEXIS 5379.

**PUNITIVE DAMAGES****A Punitive Damages Award of \$145 Million,  
Where Compensatory Damages Are \$1 Million,  
Is Excessive and Violates the Due Process Clause  
of the Fourteenth Amendment**

State Farm Mutual Automobile Insurance Company's insured was involved in an automobile accident, which killed one person and disabled another. Despite the fact that investigators and witnesses concluded that the insured caused the accident, State Farm declined to settle the claims for the policy limit. In doing so, it ignored its own investigators' advice and assured the insured that he and his wife had no liability for the accident. A jury returned a judgment for over three times the policy limit and State Farm refused to appeal. After the judgment, State Farm indicated that the insured would have to pay the judgment, but State Farm eventually paid the entire judgment. The insured sued State Farm for bad faith, fraud, and intentional infliction of emotional distress. A jury awarded \$2.6 million in compensatory damages and \$145 million in punitive damages, but the trial court reduced this to \$1 million in compensatory damages and \$25 million in punitive damages. On appeal, the Utah Supreme Court reinstated the \$145 million punitive damages award. The United States Supreme Court reversed and remanded the Utah Supreme Court's decision. The

Court applied the test set forth in *BMW of North America, Inc. v. Gore* (1996) 517 U.S. 559. In *Gore*, the Supreme Court instructed courts reviewing punitive damages to consider three guideposts: (1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases. In this case, the Court indicated that, while State Farm's conduct was not praiseworthy, the Utah Supreme Court's decision was improper because it considered and punished State Farm's nationwide policies rather than the conduct directed toward the insured in this particular case. The Court stated that a state does not have a legitimate concern in imposing punitive damages to punish a defendant for acts committed outside of the state's jurisdiction. The Court also pointed out that courts cannot punish defendants for conduct that is dissimilar to the case at hand. In considering the second guidepost, the Court declined to impose a bright-line ratio of punitive damages to compensatory damages that a punitive damages award cannot exceed. However, it did indicate that few awards exceeding a single-digit ratio would satisfy due process. The Court stated that there is a presumption against a 145-to-1 ratio. As to the third guidepost, the Court reviewed the most relevant civil sanction under Utah state law (a \$10,000 fine for an act of fraud) and noted that this amount was "dwarfed" by the \$145 million punitive damages award. Considering the three factors together, the Court held that the punitive award of \$145 million "was neither reasonable nor proportionate to the wrong committed, and it was an irrational and arbitrary deprivation of the property of the defendant." The Court remanded the case to have the Utah courts make a proper punitive damages calculation. *State Farm Mutual Ins. Co. v. Campbell* (April 7, 2003) 123 S.Ct. 1513.

## PREVAILING WAGES

### Partial Funding by City Triggers Prevailing Wage Requirements

The City of Long Beach contributed \$1.5 million to the Los Angeles SPCA for construction of an animal shelter that would serve as the SPCA's shelter and administrative headquarters, as well as providing kennels and offices for the City's animal control department. The agreement provided that City funds be used only for certain purposes. The City took the position that the prevailing wage requirements of the Labor Code did not apply because the shelter was not a public work. It further argued that, even if the shelter was a public work, the Labor Code did not apply because the project was a "municipal affair" of a chartered city. The Court of Appeal disagreed. Labor Code section 1720 defines a construction project done under contract and paid for in part by public funds as a public work. The City argued that its funds were not used for "construction," meaning the actual building of the shelter, and that the building contract was not with the City. But the Court found that, although use of the City's funds was restricted, some of those funds were used for planning, design, project management and surveying, which are included in the Department of Industrial Relations' definition of "construction." Furthermore, "under contract" did not necessarily mean a contract with the public entity providing the funds. Thus, the shelter met the definition of "public work" and the prevailing wage law applied. The Court also found that an animal shelter was not a strictly municipal affair because of the nature of the project, which was part of the SPCA-LA's countywide program. Finally, the Court held that, even if the shelter was a strictly municipal affair, the State's overriding concern to make prevailing wage law applicable to all public works trumped the City's authority. *City of Long Beach v. Department of Industrial Relations* (July 14, 2003) 2003 Cal.App. LEXIS 1050.

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**COURT WATCH** *Continued from page 9***INSURANCE COVERAGE****Insured's Action Not Necessary to Trigger Insurance Coverage**

The First Appellate District found that a tenant did not have to take any action causing an accident for its insurance coverage to be triggered. An employee of the tenant, working late at night, tripped and fell off of a third floor deck, landed on a concrete driveway and died. His parents sued the landlord. Because the landlord was an additional named insured on the tenant's insurance, it tendered the defense to the tenant's insurance carrier. The landlord was responsible for maintaining common areas, which included the deck. The lease required the tenant to indemnify the landlord, but only for the tenant's negligence or willful misconduct. The additional insured language covered the landlord "but only with respect to" the tenant's work or operations, or facilities owned or used by tenant. The tenant's carrier argued that the language required a causal connection between the tenant and the injury. The court disagreed. The language of the policy required only a minimal causal connection or incidental relationship between the liability and [the tenant's] presence in the building. *Hartford Casualty Ins. Co. v. Travelers Indemnity Co.* (July 18, 2003) 03 C.D.O.S. 6335.

**General Contractor Entitled to Coverage as Additional Insured Under Subcontractor's Policy**

Contractor was an additional named insured on a subcontractor's commercial general liability policy with respect to liability "arising out of" the subcontractor's work. An employee of a third party fell through an opening in the partially completed roof. The opening had been left when the subcontractor laid the decking for the roof and cut holes for skylights and HVAC. The contractor had attached nailers and curbs to the openings, but did not cover them. The injured party sued both the contractor and the subcontractor. The subcontractor's insurance carrier argued that the injury did not "arise out of" the subcontractor's work because the contractor was responsible for safety at the job site. The court applied the same

"minimal causal connection" test as the court in the *Hartford* case. Whether or not the accident was attributable to the subcontractor's negligence was irrelevant. *Vitton Construction Co., Inc. v. Pacific Insurance Co.* (July 22, 2003) 03 C.D.O.S. 6413.

*EDITOR'S NOTE:* In both of these insurance cases the courts noted that the carriers could require the insured's negligence be a direct cause of injury before the additional insured coverage was triggered, but that the language of the policies did not do that. Contractors should not rely on certificates of insurance, but should require that subcontractors provide them with copies of the policy so that they can review the scope of additional insured coverage.

**AFFIRMATIVE ACTION****One University of Michigan Admissions Policy Passes Muster While Another Does Not**

The United States Supreme Court recently issued two opinions regarding affirmative action programs in university admissions. It upheld one program and struck down the other. In *Grutter v. Bollinger*, the Court upheld the University of Michigan Law School's affirmative action program, and in *Gratz v. Bollinger*, it struck down the same university's undergraduate admission affirmative action program. The difference in the two programs was the role that race played in the admissions process. The Court began by stating the standard for evaluating race-based classifications. Under that standard, the program must be narrowly tailored to achieve a compelling state interest. The Court found that achieving a diverse student body is a compelling state interest. The remaining question, therefore, was whether the programs were narrowly tailored. The law school admissions program included race as one of a variety of factors that admissions officials were required to consider in evaluating applications. The admissions policy did not limit its definition of diversity to racial and ethnic status, nor did it restrict the types of diversity contributions that were entitled to "substantial weight." It did, however, affirm that the University was committed to diversity with reference to inclusion of African-American, Hispanic and Native-American students who would otherwise be underrepresented in the student body, including the need to enroll a "critical mass" of such students.

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The Court found that the policy did not amount to a quota system, not simply because there was no numeric goal, but because the program was “flexible enough to insure that each applicant is evaluated as an individual and not in a way that makes an applicant’s race or ethnicity the defining feature of his or her application.” The undergraduate policy, in contrast, awarded an automatic 20 points—out of the 100 necessary for admission—to racial and ethnic minorities. That system was not flexible enough to insure evaluation of each applicant as an individual and thus constituted an illegal quota. *Grutter v. Bollinger* (June 23, 2003) 2003 LEXIS 4800; *Gratz v. Bollinger* (June 23, 2003) 2003 LEXIS 4801.

**SURETY LIABILITY****Even When the Principal on Payment Bond Has Paid All Damages, Surety May Still Be Liable to Pay Subcontractor’s Attorney’s Fees**

In this action, a subcontractor sought payment under the contractor’s payment bond. It sued the contractor and the sureties seeking \$2 million in damages. Prior to the trial, the contractor made a statutory settlement offer. At trial, the subcontractor won, but received less than the settlement offer, and as a result, the contractor did not have to pay attorney’s fees incurred by the subcontractor after the settlement offer. The contractor then paid the judgment. The subcontractor continued to pursue the sureties for additional damages and for the post settlement offer attorney’s fees. The Court rejected the damage claim, but found that the claim for attorney’s fees had to be remanded for further factual findings. The sureties argued that they could not be responsible for the fees because the principal contractor was not. The Court, however, disagreed. There was a question of fact as to whether the sureties were included in the settlement proposal. If they were, then they had no more liability. If they were not, however, they had an obligation to pay the fees. As the court pointed out, the sureties’ obligation to pay attorney’s fees if they were not the prevailing party is a separate and primary obligation under Civil Code § 3250. Thus, the surety may still be liable for attorney’s fees even after the principal has paid its obligation. *Scott Co. of California v. United States Fidelity & Guarantee Insurance Company* (March 21, 2003) 107 Cal.App.4th 197.

**DEBARMENT****Debarment Proceeding Affords Due Process and Fair Hearing Before an Impartial Tribunal**

A contractor received a permanent debarment after an administrative hearing and subsequent rehearing. Prior to the hearings the contractor had the opportunity to depose 19 city employees, to review all of the City’s evidence, and to submit unlimited briefs, declarations and deposition transcripts. The contractor then filed a writ of mandamus seeking a ruling that the hearing process denied it due process and seeking a reduction of the debarment. The court denied the contractor’s due process argument, but reduced the debarment. The contractor then appealed the decision on its writ, arguing primarily that it was not allowed to present live rebuttal testimony or cross-examine witnesses. The contractor cited a United States Supreme Court case that found the inability to cross-examine witnesses denied due process to New York welfare recipients. The court found that the procedure employed in San Diego was sufficient. The basic test was whether the contractor was offered “an opportunity to be heard at a meaningful time and in a meaningful manner.” The concept of due process, said the court, is flexible and depends on the specific circumstances. It pointed out that, unlike welfare recipients who probably could not write effectively and who lacked assistance of counsel, the opportunity to present a written submission afforded the contractor adequate opportunity to present its case. The contractor was a “sophisticated business entity and had professional assistance of counsel.” In addition, the contractor had the opportunity to confront the witnesses at deposition. The court, therefore, affirmed the debarment decision on appeal. On the City’s cross-appeal, the Court reinstated the permanent debarment. *Southern California Underground Contractors, Inc. v. City of San Diego* (May 6, 2003) 108 Cal.App.4th 533.

—Teresa Jenkins Main ❖



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