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News in Brief

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Greetings from the Editor

The first decade of the 21st century may mark a turning point in the balance of traditional construction of public buildings and those constructed using "green" building methods and materials. Increasingly, national, state, and local governments require that public buildings meet specific green-building standards, such as "LEED" in the United States or "BREEAM" in Great Britain. In the Bay Area, San Francisco recently became the first American city to apply environmental standards—including solar panels, recycled building materials, energy efficient appliances, bamboo floors, natural light, and better insulation—to all new affordable-housing projects. The new federal energy bill also includes incentives and guidelines for green buildings, and regulations for new federal buildings. Private projects, although less often government regulated, are also increasingly incorporating green principles. Our cover story on green construction explains more about LEED certification and explores the wide-ranging benefits of building green. You can learn even more about this topic when Dr. Malcolm Lewis of Constructive Technologies Group, Inc., speaks at our Breakfast Forum on Friday, October 21, 2005. For more information, see page 5 or visit us online at www.brhlaw.com.

—**Teresa Jenkins Main** ❖

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Going for the Green

Green construction is the hottest issue in the building trades today, and no contractor, developer, owner, or government official can afford to be in the dark about the opportunities to increase profits, cut energy costs, save resources, and make workers happier and more productive by going green. From Boston and Chicago to Austin and Seattle, cities across America have enacted legislation requiring that new buildings be environmentally friendly and energy-efficient. While numerous jurisdictions have issued green executive orders, Washington state broke new ground in April 2005 when its legislature became the first to pass laws requiring all public buildings to be green, and to meet or exceed standards established by the U.S. Green Building Council, known as Leadership in Energy and Environmental Design, or LEED.

The U.S. Green Building Council developed LEED in 2000 to further the goals of green construction. The purpose was to define green construction by establishing a common standard of measurement in order to promote integrated, whole-building design practices, recognize environmental leadership in the building industry, and stimulate green-building competition. The developers of the LEED standards aimed to raise consumer awareness of green-building benefits and eventually transform the national building market. The widespread shift toward green construction is a concrete measure of this agenda's success.

Essentially a rating system, LEED measures a building's environmental impact. The LEED evaluation process requires a building to meet a number of prerequisites. After doing so, the building is graded on a point system weighted in six categories: sustainable sites; water efficiency; energy and atmosphere; material and resources; indoor environmental quality; and innovation and design. The more points a building accumulates, the higher its rating. The rating itself quantifies the reduction of the environmental impact of the green building over an equivalent, conventional building. Ranging from "certified" to "platinum," LEED's ratings have become the touchstone for environmental design. A "gold" rated building has an approximate 50% reduction in its environmental impact, while a "platinum" building's impact is reduced by around 70% over conventional construction. Most of the state and city green-construction ordinances require a minimum of a "silver" rating, which demonstrates an environmental impact reduction of around 35%.

The benefits of green construction extend far beyond lowering the environmental impact of a building and the energy costs of the end-user—buildings that meet LEED standards boast reduced operations and maintenance costs, provide a better working environment, and have been shown to improve employees' health and productivity, thereby reducing legal liability for workers' compensation claims. A high LEED rating may even boost property values.

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Going for the Green

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Today, buildings in the United States consume 30–35% of the nation's energy and produce 30% of the nation's greenhouse gas emissions. A silver-certified building, however, can result in energy usage 30% less than a comparable, nongreen building. According to the U.S. Green Building Council, a gold rating can be achieved with only a 2% average increase in construction costs, which typically pays for itself within two years due to lower utility bills. For instance, the forty-one story Swiss Re Tower in London, with its circular design and environmentally-friendly construction, consumes approximately 50% less energy than a comparable conventional office building. In the Condé Nast Building in New York City's Times Square—constructed prior to LEED standards, but heavily influenced by green concepts and influential on the standards—natural light shines through state-of-the-art glass, which reduces the need for interior artificial light, natural gas powers fuel cells providing the building's nighttime energy and 5% of the daytime energy needs, the fuel cells' hot water exhaust contributes to the building's heating and hot water, motion sensors turn off unneeded lights, and exit signs are illuminated by diodes rather than light bulbs. These are just some of the building's features that result in 40% less energy consumption than a comparable nongreen building.

As governments require public—and in the case of Chicago, private—construction to be green, increasing numbers of projects are LEED certified. For example, in Torrance, California, a gold-rated Toyota office building uses a variety of green technologies, including solar energy. New York City's Freedom Tower, perhaps the highest profile construction project on the planet, will incorporate solar panels and wind-driven turbines to provide about 20% of the building's energy. Natural light and ventilation, and energy-efficient lighting will also provide green benefits.

While green construction can lower energy costs, it can also act to increase the energy of its end-users; several studies and anecdotal evidence suggest employees are happier and more productive working in a green office building. A study by the University of Michigan concluded that office employees who work under natural daylight and with views of a natural landscape had higher job satisfaction, less stress, and fewer illnesses than employees in nongreen buildings. Indeed, Lockheed Martin experienced a 15% drop in the number of absent employees after it relocated 2,500 employees to a new green building in Sunnyvale, California. While Lockheed's new green building cost more to build than a nongreen one, higher productivity resulting from a reduction in absenteeism increased profits that paid for the difference within a year.

The benefits of natural lighting are not confined to the office. According to a California consultant, retail sales in stores with skylights increased by almost 40% over stores without natural light. Similarly, students whose classrooms were naturally lit improved their test scores by 20%.

On top of the benefits of lower energy costs, lower greenhouse gas emissions, increased worker productivity, higher retail sales, and better student test scores, green construction also lowers the building owner's liability by lessening the likelihood of litigation for "sick building syndrome" (SBS). SBS occurs when the occupants of a building suffer from acute health effects that are linked to the victim's time spent inside the building. Despite the physical ailments, no specific illness or cause can be identified. SBS was first identified following the construction of so-called "sealed box" buildings in the 1970's. SBS causes employee productivity and satisfaction to plummet and absenteeism to increase. Despite considerable effort, no specific cause of SBS has been identified and it appears to be caused by various factors such as toxic emissions from carpeting, upholstery, adhesives, treated wood, and other materials used in construction. Green construction lessens the likelihood of SBS and SBS lawsuits by increasing natural ventilation and light, and using environmentally-friendly materials. For example, traditional forms of insulation are cast aside in some green buildings in favor of recycled paper and fabrics, including old denim jeans. These materials are considered more effective, more environmentally friendly, and less expensive than traditional insulation. Finally, with the reduced likelihood of SBS lawsuits, some owners find their insurance premiums reduced.

With benefits such as these, green construction is gaining favor and momentum around the world. London's Swiss Re Tower is already a model of green technology and benefits. In 2003, one quarter of Britain's new office buildings met the British LEED equivalent, the BREEAM standard. As China gears up to host the 2008 Olympic Games, all related buildings and sports venues are to be

built using green-construction values. New Zealand, Australia, and Canada have all adopted LEED equivalent standards.

Here in the United States, Chicago and San Francisco are the leaders in transforming American urban centers into environmentally friendly models. Chicago has long been on the cutting edge of American construction. The "Second City" was home to what is generally considered the world's first skyscraper: the steel-framed, nine-story Home Insurance Building constructed in 1885. Over one hundred years later, Chicago—under the leadership of Mayor Richard M. Daley—is the national pacesetter for green construction.

Since 1989, Mayor Daley has pursued various environmental policies such as rooftop gardens, city-wide tree plantings, wetland restoration, sewer upgrades, and alternative energy sources. Between 1989 and 2004, Chicago encouraged green construction with incentive programs. In 2004, Chicago passed two ordinances, one requiring green construction for city projects and one for certain private construction. Chicago's green requirements, known as the Chicago Standard, are modified from LEED to suit Chicago's needs. For example, the Chicago Standard evaluates the ability to handle storm-water, which is essential for Chicago's rain-filled summers and for snow runoff in the winter and spring. Also, the urban "heat island effect" is pervasive in Chicago due to the summer heat, concrete paving, and dark city rooftops. To combat this, the Chicago Standard gives extra weight to green roofs, which are composed of vegetation. This cools the building underneath it and retains some rainwater runoff.

Chicago has also taken the additional step of requiring green criteria for some private construction projects subsidized by the city or those subject to city review. Because lakefront construction projects are included in the latter category, approximately 200 private green construction projects have been mandated in the last two years and are now underway.

Like Chicago, San Francisco has long encouraged green construction. In 1999, San Francisco instituted a pilot program for the greening of public construction. Eleven Grove Street, the Moscone West Convention Center, and the San Francisco Municipal Office Building at 525 Golden Gate Avenue are all green projects. However, all of these pale in comparison to the ambitious reconstruction of the California Academy of Sciences in Golden Gate Park.

With its previous buildings already in disrepair, the California Academy of Sciences was severely damaged by the 1989 Loma Prieta earthquake. On December 31, 2003, construction commenced on new, seismically safe and green buildings for the Academy. Financed through a public-private partnership that has yielded over $200 million in construction funds, the new buildings will be models of green success and will strive to achieve the LEED platinum certification. The building's living roof will absorb significant amounts of rainwater, preventing up to two million gallons of rainwater—an approximate 50% reduction—from becoming storm water runoff, which carries salt, sand, pesticides, fertilizers, oil, and other pollutants into the local ecosystem. Moreover, the green roof will provide excellent insulation, particularly during warm temperatures, and the native California plants will create a habitat for honeybees and various other wildlife. To encourage lower energy usage, the exhibit and office areas will be naturally ventilated and biofuel—a clean, renewable, nontoxic fossil-fuel substitute—will be used in the Academy's boilers. Floor-to-ceiling high performance glass will provide natural daylight while limiting solar heating effects. Overall, the new buildings will consume at least 50% less energy and have maintenance and operating costs 60% below a comparable nongreen building.

With no fewer than fifteen major American metropolitan areas now requiring at least LEED silver certification for new public and some private construction projects, owners, designers, and builders must cooperate and plan to succeed in the work of green construction. No longer is providing the lowest initial cost for a construction project the only factor. Green buildings are often more complex than conventional ones and require vigilant coordination and thoughtful planning. Three- or four-dimensional computer modeling and close, early coordination between the architects, the engineers, and the general contractor can prevent problems from occurring later in the process. With close cooperation, green construction costs, though marginally higher than traditional construction, can be kept to a minimum while developers and inhabitants can profit from the long-term benefits of lower energy usage, decreased costs, and environmentally friendly technologies.

—Christian A. Carrillo ❖

To learn more about green construction and to see a list of green resources and links, visit us at www.brhlaw.com.

SUBCONTRACTORS SEEK BAN ON TYPE I INDEMNITY FOR RESIDENTIAL CONSTRUCTION PROJECTS

The California legislature recently passed a bill that prohibits courts from enforcing certain clauses in residential construction contracts. AB 758 prohibits courts from enforcing clauses that oblige residential subcontractors to bear all financial responsibility for correction of construction defects that were partly the result of the negligence of the general contractor or another subcontractor. The Governor signed AB 758 on September 29, 2005.

Assemblymember Ron Calderon, Democrat of Montebello, introduced AB 758 to correct what he believed to be an inequitable and economically inefficient allocation of litigation risks between residential builders and their subcontractors. Under previous law, courts could enforce clauses that required a subcontractor to pay all claims arising out of defects in the subcontractor's work, even if the court (or jury) determines that the general contractor or another of its subcontractors was 99% responsible for the defect and the defendant subcontractor was only 1% responsible. Furthermore, courts could also enforce clauses that required the subcontractor to pay the general contractor's costs to defend litigation arising out of the subcontractor's work, even if the builder or another subcontractor was principally responsible for the defect that gave rise to the litigation. However, the law prohibited courts from enforcing contract clauses that forced a subcontractor to pay claims or defense costs arising out of defects that were wholly the fault of the builder. In effect, general contractors could, under previous law, impose strict liability on subcontractors for any defects except those that are wholly the fault of the general contractor.

AB 758 authorizes courts to enforce agreements that require a subcontractor to "front" the defense costs, even if its fault for a defect is relatively minor compared to that of the general contractor or another subcontractor. However, the agreement cannot require that a subcontractor waive claims for reimbursement for the costs it incurred defending the general contractor or another subcontractor after "final resolution" of the defect claim.

AB 758 will not alter the defense obligations of subcontractors' insurance carriers. A subcontractor's liability policy often names the general contractor as an "additional insured." Under previous law, the subcontractor's carrier could have been obligated to pay a general contractor's defense costs for claims arising from construction defects, even if the claims against the general contractor implicate the subcontractor's work only tangentially. (*Presley Homes, Inc. v. American States Insurance Company* (2001) 90 Cal.App.4th 571.) Thus—in theory—when an owner sued a general contractor for a defect claim, the general contractor could demand that any and all of its subcontractors' carriers foot the bill for defending the claim. Assemblymember Calderon's original version of AB 758 would have relieved carriers from these defense obligations. However, the Assembly ultimately passed a version that reaffirmed these defense obligations, and specifically stated that the bill did not alter the holding of Presley Homes.

The provisions in AB 758 apply to residential construction contracts entered after January 1, 2006 and general contractors, subcontractors, and their lawyers could no longer assume that subcontractors will pay the entire claim arising out of a construction defect. General contractors, subcontractors, and their lawyers should attentively negotiate separate clauses concerning defense obligations, and not rely, as they commonly do now, on general legal principles that impose defense duties on subcontractors who promise to indemnify general contractors for liability arising out of their work. Defense clauses should address whether a subcontractor must pay for the general contractor's defense costs before there is a finding of liability or only after.

And there are additional reasons that both residential and commercial builders should negotiate contract clauses that explicitly address the duty of a subcontractor to defend claims brought against the general contractor. In a 1994 decision, the California Court of Appeals determined that it was unable to assess whether a subcontractor had a duty to pay the general contractor for defending a lawsuit arising out of its work without first determining whether the subcontractor was at fault for the defect. (*Regan*

BR&H BREAKFAST FORUM

BR&H Breakfast Forum welcomes
Dr. Malcolm Lewis of CTG Energetics, Inc.

Building Green

Please note the Breakfast Forum's new, convenient location:

DATE
Friday, October 21, 2005

TIME
7:30 A.M. Complimentary Continental Breakfast
8:00 A.M. Presentation

LOCATION
Scott's Restaurant
2 Broadway, Jack London Square, Oakland

Valet Parking Available
Directions at: www.scottsrestaurants.com

We anticipate that this will be a very well-attended session so PLEASE reserve your place early by contacting:

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Opportunities for Contractors with LEED

GREEN CONSTRUCTION is the hottest topic in the building trades today. Find out how building green can benefit all participants in the development and construction industries.

As the engineer of record for over 25 million square feet of new construction, Dr. Malcolm Lewis is one of the nation's premier experts on green energy and sustainable construction. His firm has served as the sustainability consultants for over 100 green-building projects, and he is a leader in moving the building industry towards a green future. He will be speaking on how all participants in the construction industry—owners, developers, contractors, and subs—can reap benefits from the Green Building and LEED (Leadership in Energy and Environmental Design) movement.

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Roofing Company v. Superior Court of San Diego (Pacific Scene) (1994)) The Court distinguished the subcontractor's duty under the indemnity agreement from an insurer's duty to defend, which the Court described as "freestanding," meaning that the insurer must pay for a defense immediately whenever there is a potential for coverage. *Regan Roofing* suggests that the subcontractor's duty to defend may not be "free-standing" and is, instead, contingent on a determination of fault. Thus, a general contractor that looked to its subcontractors to defend a lawsuit arising out of their work could not go to court to ask for a judicial determination of duty, unless and until the court first determined whether the subcontractors were at fault. The general contractor, the subcontractor, and their lawyers should negotiate "freestanding" defense clauses that explicitly state the terms of the subcontractors' defense duties.

—**Anthony L. Critchlow** ❖

PUBLIC–PRIVATE PARTNERSHIPS FOR SCHOOL CONSTRUCTION UNDER CALIFORNIA EDUCATION CODE SECTION 17406: UNDER ATTACK IN THE LEGISLATURE

When I sat down to write this article, I intended to offer an alternative view to the article written by Teresa Jenkins Main in our February 2005 edition of *News in Brief*. Teresa wrote that the State Allocation Board was concerned that Education Code section 17406 is being used as a vehicle to improperly avoid public bidding on public school construction projects, and closely reviewing such projects. While not disagreeing with her, my intent was to highlight some of the real merits to the lease-leaseback option under section 17406 for building public schools in California.

In brief, section 17406 allows a school district—without public bidding—to lease property it owns to a party that in turn promises to build a building or buildings for the school district's use with title to return to the school district at the expiration of the lease.

Section 17406 allows a governing school board—without advertising for bids — to lease for a minimum rental of $1.00 per year to any person, firm, or corporation, any real property belonging to the school district if the lease provides for the construction of a building or buildings for the use of the school district during the term of the lease and provides that title to the building will vest in the school district at the expiration of the lease terms.

One might ask, "What is wrong with that?" In today's economy, shouldn't public entities be allowed to explore alternative methods of construction project delivery? To answer this question, I researched further into the origin of section 17406, and what if any changes had been made over the years to this quirk in public construction procurement legislation.

To my surprise, I discovered that section 17406 is currently under attack in the Legislature. There is presently a bill in the California Assembly that seeks to rewrite section 17406.

AB 1162, introduced by Assemblymember Gene Mullin, Democrat of San Mateo, would eliminate a school district's authority to lease property for purposes of entering into a lease-leaseback arrangement without advertising for bids, and would instead require the leases to be let through a "competitive proposal process" as defined in Education Code section 17429.1.

Assemblymember Mullin's bill was not the first time the lease-leaseback legislation had come under attack. In 2003, Former Assembly Member John Dutra introduced AB 1486, which attempted to create a competitive selections process for lease-leaseback contracts.

Assemblymember Dutra's bill actually passed both houses and was sent to the Governor for his signature. The Governor vetoed the bill, noting that "this bill [1486] imposes restrictions on lease-leaseback contracts that could limit competition, inadvertently limit schools' flexibility, and drive higher administrative costs, thereby potentially increasing the overall cost of school facility construction."

This year, Assemblymember Mullin reintroduced essentially the same bill as Assemblymember Dutra. Assemblymember Mullin's comments in support of the legislation, as recorded by the Legislature Analyst's Office (LAO), cited the use of progress payments disguised as lease payments as a particular evil, undermining the competitive bid process. Assemblymember Mullin posits that "progress payments made under the design-bid-build method, while 'cumbersome,' protects the integrity of the bidding process and ensures that districts get the lowest price for their school construction project and don't rig the process to promote favoritism."

Whether a lease payment is really a progress payment and whether progress payments made under the design-bid-build method actually protect the integrity of the bidding process and ensure the lowest price, is the subject of another article. What is clear though, is that the public, and in particular the construction industry, gain as a whole with legislation that promotes free, fair and open competition for public construction projects in California.

The Legislature's stated objective in enacting the Public Contract Code was in part to "preserve full compliance with competitive bidding statutes, to protect the public

from misuse of public funds, to provide qualified bidders with a fair opportunity to enter the bidding process, and to eliminate favoritism, fraud and corruption in the awarding of public contracts." (Public Contract Code § 100)

AB 1162 advances the laudable goal of a more transparent bidding and construction process. It would require the governing board of a school district to conduct a competitive bidding process in order to lease real property for construction purposes. Before leasing the property the governing board must make written findings that use of the lease-leaseback will do one of the following:

a) Reduce comparable project costs;

b) Expedite the completion of the project; or

c) Provide features not achievable through the traditional design-bid-build method.

The proposed legislation also requires the lease-leaseback process to contain a request for proposal (RFP) with specified requirements. School district boards must also establish procedures and criteria for final selection. Such criteria are to include the experience and qualifications of the lease-leaseback entity in school facility delivery, cost savings, project schedule estimates, project features, project functions, and if applicable, the suitability of the financing offered by the lease-leaseback entity.

Assemblymember Mullin's bill is supported by the California Labor Federation, AFL-CIO, California State Council of Laborers and the Construction Industry Force Account Council. It is opposed by the Associated Builders and Contractors of California and the San Diego Office of Education.

One noted point of contention in the proposed legislation is the element of "skilled labor force availability" as part of the criteria to be considered by the school district in a required evaluation and ranking process. At least 10% of the total "weight" is to be based on price, skilled labor force availability and acceptable safety record.

"Skilled labor force availability" in the proposed legislation means that an agreement exists with a registered apprenticeship program, approved by the California Apprenticeship Council, which graduated apprentices in each of the immediately proceeding five years.

The LAO cites the opposition to AB 1162 from Associated Builders and Contractors of California as stating that the skilled labor force provision is "intended for nothing more than to prevent Merit Shop Companies from freely bidding on state-funded construction work."

> IN BRIEF, SECTION 17406 ALLOWS A SCHOOL DISTRICT – WITHOUT PUBLIC BIDDING – TO LEASE PROPERTY IT OWNS TO A PARTY THAT IN TURN PROMISES TO BUILD A BUILDING OR BUILDINGS FOR THE SCHOOL DISTRICT'S USE WITH TITLE TO RETURN TO THE SCHOOL DISTRICT AT THE EXPIRATION OF THE LEASE.

Whether the proposed legislation is intended to prevent Merit Shop Companies from bidding on state-funded construction or not, one does get the sense that AB 1162 strays far afield from Assemblymember Mullin's comments in support of the legislation that the use of lease payments as progress payments in the lease-leaseback process undermines the integrity of the bidding process. In fact, AB 1162 offers no discernible mechanism for eradicating use of lease payments as progress payments under a lease-leaseback project.

Section 17406 as it currently is written does not prohibit a public school district from self-financing a lease-leaseback construction project through "lease payments." The fact that AB 1162 ultimately makes no attempt to address the funding and progress payment issue through the use of "lease payments" lends credence to the argument that the intent of the proposed legislation is more, or perhaps, less, than what meets the eye when reading the comments of its author in support of AB 1162.

The Legislature enacted section 17406 to permit school districts more flexibility in public construction procurement, a concept the Governor cited last year in vetoing the predecessor of AB 1162. The Governor is likely to cite that principle again this year as he vetoes AB 1162.

—Kimble R. Cook ❖

Court Watch

MW Erectors, Inc. v. Niederhauser Ornamental & Metal Works Co., Inc.
(July 14, 2005) Cal. LEXIS 7443

Out-of-state contractors should pay particularly close attention to the recent California Supreme Court decision of *MW Erectors, Inc. v. Niederhauser Ornamental & Metal Works Co., Inc.*

An unlicensed contractor executed two separate contracts, one for structural steel work and the other for ornamental steel work. The subcontractor was unlicensed when it executed the contracts and when it began the structural steel work, but obtained a license before it began the ornamental work.

When a payment dispute arose, the subcontractor sued to recover for work performed under both contracts. The contractor asserted that the subcontractor's claims were barred under California Business & Professions Code § 7131(a) because the subcontractor had not been properly licensed at all times during the performance of the contracts. The trial court agreed with the contractor and granted a motion for summary judgment against the subcontractor.

The Court of Appeal of California reversed, holding that the subcontractor was entitled to prove amounts due for its work on the structural contract after the license was issued. The Supreme Court disagreed and reversed the judgment. Because the subcontractor was not duly licensed at all times during performance of the structural contract—as required by Business and Professional Code, § 7031(a)—and the subcontractor could not establish its substantial compliance with the licensure requirements because it had never held a valid California contractor's license prior to beginning performance under former § 7031(d), the subcontractor could not sue to recover any compensation for work performed under the structural contract.

With regard to the ornamental contract, the Supreme Court ruled that section 7131 does not require that the contractor be licensed when it executes the contract. Thus, the subcontractor was not barred from recovering compensation for its work under the ornamental contract on the sole ground that it was unlicensed when it executed that agreement. The issue of proper licensure was remanded to the trial court for further review.

Mike M. Johnson, Inc. v. County of Spokane
(2003) 150 Wash.2d 375, 78 P.3d 161

In *Mike M. Johnson, Inc. v. County of Spokane,* the county awarded a contract to construct two sewer projects. The county later revised the plans, and issued a change order to the contractor that required the contractor to widen an avenue. The change order included a proposal to increase the contractor's compensation for the additional work. The contractor made no objection to the change order, but encountered buried telephone lines when performing the additional work. The contractor later alleged that its performance was delayed after it discovered the telephone lines and sought to recover delay damages from the court.

Both contracts required the contractor to use mandatory notice, protest, and formal claim procedures for claims of additional compensation, time extensions, and changed conditions. Instead of following the contract procedures, the contractor wrote several letters asserting that it had been damaged and delayed. The county responded by claiming that the contractor was not entitled to additional costs and damages because it had not complied with the contract notice provisions.

The contractor filed suit against the county and the trial court denied the contractor relief because the contractor had "failed to comply with mandatory contractual protest and claim provisions." On appeal, the Court of Appeals of Washington State reversed and held that there was an issue of material fact regarding whether the county's actual notice of the contractor's claims excused the contractor from complying with the mandatory contractual protest and claim procedures.

The issue on appeal was whether "actual notice" was an exception to compliance with the mandatory contractual protest and claim provisions. The Washington Supreme Court held that it was not and that the long-established rule in Washington required contractors to follow contractual notice provisions unless those procedures

were waived by the owner. Although the contractor submitted letters to the county indicating that it was concerned about that change order and expected additional compensation after the telephone lines were discovered, the county's response did not evidence an intent to waive the contract requirements. The Court also found that the evidence did not establish a question of whether the county waived enforcement of the claim procedures through its conduct.

Central Building, LLC v. Cooper
(2005) 129 Cal.App.4th 759

In *Central Building LLC v. Cooper,* a lessee defaulted by failing to make lease payments and the lessor filed suit to collect guarantors. Among other things, the guarantors argued that the guaranty did not apply an amended version of the lease negotiated between the leasor and lessee even though the amended lease specifically provided that the personal guaranties were additional consideration for the modified lease agreement.

The court of appeal affirmed the trial court's decision, holding that the guarantee agreement applied to present and future obligations under the lease and created a continuing guaranty, as specifically stated in the guarantee agreement. In general, a continuing guarantee can be revoked at any time. However, the guarantee in question in this case was expressly made irrevocable and had no expiration date. The language in the lease and guaranty agreements made the guaranty applicable to modifications in the lease such as extensions in the lease term. In addition, the guarantors expressly waived their statutory right under California Civil Code Section 2819 to exoneration when the original obligation was altered.

A modification of an underlying obligation generally does not revoke a continuing guaranty, but only modifies the guaranty in the same way that the underlying obligation is modified. The guarantor is only discharged if the modification (other than an extension of time) creates a substituted contract (i.e., a new contract that discharges or satisfies the original duty and therefore discharges the guarantor) or imposes risks on the secondary obligor fundamentally different from those imposed pursuant to the transaction prior to modification.

Cronus Investments v. Concierge Services

In *Cronus Investments v. Concierge Services* Colman and Westrec Marina Management, Inc. were the only two members of Concierge Services LLC. Colman was fired from his position as president of Concierge and filed a demand for arbitration against Concierge and Westrec pursuant to an arbitration provision within his employment agreement. Concierge and related entities filed a state court cross-complaint against Colman. The trial court stayed the arbitration pending the outcome of the litigation pursuant to California Code of Civil Procedure Section 1281(c) (part of the California Arbitration Act) noting that only three of the eight cross-claims were arbitable and some of the litigants were not parties to the arbitration agreements.

Colman argued that the Federal Arbitration Act preempted California Code of Civil Procedure Section 1281(c). Concierge argued that the procedural provisions of the FAA do not apply in state courts where the parties had agreed that their arbitration agreement would be governed by the law of California. (See *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.* (1989) 489 U.S. 468 (*Volt*))

The California Supreme court determined that neither Congressional intent nor the U.S. Supreme Court precedent state that the FAA's procedural rules apply to state courts absent the parties' effective explicit election. The Court concluded that the FAA preempts state substantive arbitration law and state procedural arbitration law that runs counter to the federal policy favoring arbitration. The Court upheld the trial-court's decision applying staying arbitration because Section 1281(c) does not contradict the federal policy favoring arbitration.

Frei v. Davey
(2004) 124 Cal.App.4th 1506; 22 Cal. Rptr. 3d 429

In *Frei v. Davey,* a residential purchase agreement contained a provision permitting recovery of attorney fees by a prevailing party, unless the prevailing party refused to participate in mediation before litigation or arbitration was commenced.

After the sellers filed suit, the buyers continued to request mediation and extended the sellers' time to respond to the request. The sellers refused to mediate. Communications between the parties regarding settlement were not the same as mediation. The lack of a perceived likelihood of success from mediation did not excuse the sellers from complying with the agreement's terms. The court held that—even assuming the agreement provided a reasonable time period to respond to a request

for mediation—a delay of almost one year between the request for mediation and the mediation conducted shortly before the initial trial date was not reasonable. Under the terms of the contract, the buyers' lawsuit to record a lis pendens against the property did not negate the agreement's mediation provision.

In accordance with the parties' express agreement, the court held that the prevailing parties are barred from recovering attorney fees because they refused a request to mediate. The court held that the provision barring recovery of attorney fees by a prevailing party who refuses a request for mediation means what it says and will be enforced.

The standard-form residential purchase agreement used in California has a recently added clause providing that a prevailing party in litigation or arbitration who *refused* a request to mediate made before the commencement of such proceedings is barred from recovering attorney fees. This is the first published case in which this provision has been applied.

Westra v. Marcus & Millichap Real Estate Investment Brokerage Company
(2005) 129 Cal.App.4th 759

Plaintiff purchasers of a parcel of real estate sued defendant real-estate company for fraud. The Superior Court of San Francisco County, California, denied the company's petition to compel arbitration. The company appealed.

While the company did not claim that it was a party to the purchase agreement, it contended the trial court erred by denying its petition to compel arbitration because: (1) it was entitled to enforce the arbitration agreement as an agent for a signatory party; (2) the other parties agreed to arbitration; (3) the company was an intended third party beneficiary; and (4) arbitration of all claims together in a "single trial" would be preferable to pursuing one set of claims in arbitration and the other in litigation. The court concluded that the company's first two arguments were meritorious. The company acted as an agent for both parties to the purchase agreement and its arbitration agreement in a preexisting agency relationship. The language of the purchase agreement, as well as the arbitration provision itself, clearly stated that the purchasers, the sellers, and the company agreed to arbitrate disputes involving the subject matter of the purchase agreement. The language of the purchase agreement was binding on the company. As an agent, the company was entitled to enforce the arbitration agreement. The order denying the petition to compel arbitration filed by the company was reversed.

N.V. Heathorn, Inc. v. County of San Mateo
(2005) 126 Cal.App.4th 1526

Plaintiff, an unpaid subcontractor on a public project, sued defendant county, seeking to hold the county liable after it discovered that the county failed to obtain a payment bond from the bankrupt general contractor as required by California Civil Code § 3247. The San Mateo County Superior Court, California, entered a judgment of dismissal after it sustained the county's demurrer without leave to amend. The subcontractor appealed.

The subcontractor argued that the county breached a statutory obligation to assure that the general contractor secured a payment bond, and that the subcontractor was injured as a result. The court held that the injury to the subcontractor resulting from the county's failure to discharge its statutory duty to obtain a payment bond from the original contractor on a public work of improvement qualified as an "injury" to support a cause of action under Cal. Gov't Code § 815.6. The loss of payment security suffered by the subcontractor due to lack of a payment bond was an injury to the types of interest that were protected in actions between private persons. Because the project was a government project, the subcontractor could not assert a mechanic's lien under the principle of sovereign immunity. The only remedies available to the subcontractor were stop notices and actions on public works payment bonds.

The judgment was reversed. Costs on appeal were awarded to the subcontractor.

Spotlight on Green Construction

WEBCOR BUILDERS
is constructing the new Natural History Museum for the California Academy of Sciences in Golden Gate Park, San Francisco. The five-story, structural-concrete facility, designed by Renzo Piano Building Workshop/Chong Partners, is a marvelous fusion of cutting-edge technology with advanced sustainable design and resources conservation. As a tangible expression of the facility's thoroughly green spirit, the undulating roof plane will be covered with living vegetation that gracefully melds into the surrounding natural environment of the park.

To learn more about green construction and to see a list of green resources and links, visit us at www.brhlaw.com.

M.A. MORTENSON COMPANY'S extensive green-building experience proved invaluable during the construction of the new Washington State Department of Ecology Headquarters, designed by the McGranahan Partnership. Mortenson helped the project meet stringent energy and water efficiency standards, incorporate recycled and sustainable materials, and use the latest in green HVAC and wastewater handling techniques.

S.J. AMOROSO is building a unique one-building campus for Vista Community College in Berkeley, California. Ratcliff Architects designed the six-story, 165,000 sq. ft. building to meet LEED Silver Certification by incorporating efficient mechanical systems and using green materials such as "blue jean" insulation made from recycled denim. The facility features a full-height atrium for natural daylighting and circulation.

Involuntary Bankruptcy: An Overlooked Remedy in Construction Disputes

Involuntary bankruptcy is one tool available to address a common experience in construction and a headache that many general contractors have experienced: A supplier hired by a subcontractor files a mechanic's lien or stop notice on the project. The general contractor investigates and determines that it paid the subcontractor for the supplier's bill a few months before. But the subcontractor did not use those funds to pay the supplier—and as it often turns out—the funds were diverted to pay off other, more pressing debts.

At this point, the general learns that its subcontractor is in dire financial straits, possibly facing collapse, and threatening project completion. While this situation often occurs when the general contractor works with an unfamiliar subcontractor, it can also occur with a subcontractor the general has worked with for years. The end result is usually the same: the general contractor gets stuck paying the supplier's bill twice, simply to get the lien removed and the job moving. The general then files suit against the subcontractor to recover the second payment, and by the time the action is underway, the subcontractor is insolvent and there is little or nothing left to recover.

There are a variety of well known techniques to avoid this situation, such as issuing joint checks, or conducting a credit investigation of the subcontractor. Most of the time, however, the issue does not arise until it is too late and when working with a trusted or well reputed subcontractor, the general often has no reason to suspect trouble. Among the lesser known tools to address this situation is the involuntary bankruptcy petition. Although infrequently used, it can be effective when the general holds a liquidated claim against the subcontractor, the subcontractor is equitably insolvent, and there are few creditors who are similarly situated. This article will discuss the procedures for using this approach.

Requirements for Filing the Involuntary Bankruptcy Petition

The involuntary bankruptcy petition is unique because it reverses the normal bankruptcy filing process. With a voluntary petition, the debtor files to initiate the proceedings. With an involuntary petition, the *creditors* file the petition and pull the debtor into the court, hence the term "involuntary."

As one can imagine, the procedural requirements for filing an involuntary petition are stricter than those for a voluntary petition, otherwise creditors would have free reign to call debtors into court. Several conditions must be met to petition for an order for relief from the court.

First, the total aggregate of claims against the debtor must be at least $12,300. This requirement can be met by 12,300 creditors each holding a $1 claim, or a single creditor holding a $12,300 claim, or any combination inbetween. The claims cannot be "contingent as to liability or the subject of a bona fide dispute as to liability or amount." This means that unliquidated claims—such as disputed breach of contract actions—cannot be used to fulfill the $12,300 requirement. In most large construction projects, however, the jilted material suppliers will have claims against the subcontractor above this requirement. When the contractor pays the supplier's claims, the contractor becomes the holder of those claims and can assert them against the subcontractor.

Second, a threshold number of creditors must participate in filing the involuntary petition. If the debtor has 12 or more creditors, at least three must join in the petition. If the debtor has fewer than 12 creditors, any single creditor can initiate the petition. Claim trafficking is forbidden—if there are more than 12 creditors, a single creditor cannot split up his claim to create three claims and meet the threshold.

Thus, although in most instances the aggregate claim requirement will be met, the contractor must research the size of the creditor class to determine if, there are others waiting to be paid in addition to the aggrieved suppler. If there are 12 or more creditors, the general must convince at least two others to go along with the petition. This requirement represents the greatest procedural burden to filing an involuntary petition and it may be impossible to overcome. Once the creditor or creditors file and serve the petition, the debtor has 20 days to contest it. If the petition is uncontested, the court will enter an order for relief against the debtor. However, if the debtor contests the petition, the bankruptcy court will enter the order for relief only if the

petitioning creditors can establish that the debtor is generally not paying debts as they become due, unless the debts are subject to a bona fide dispute. This is known as equity insolvency.

The court will conduct a hearing or a trial to determine if the debtor is equitably insolvent. The court will examine the percentage and value of debts in default, and will also consider the relative importance of unpaid debts, the length of time payments are overdue, how much debts have increased over time, and the degree of irresponsibility of the debtor. This determination can be a time consuming and fact intensive process, and the creditors must be prepared to cooperate and be patient.

If the court determines the debtor is equitably insolvent, the court will grant an order for relief. The court's order for relief acts like a judgment, placing the debtor in bankruptcy and commencing the bankruptcy case.

Why File the Involuntary Petition?

For a general contractor, there is no optimum outcome in the situation described above. Bankruptcy court proceedings are probably inevitable and the only question is when it will occur. Typically, the debtor files for bankruptcy after all of its creditors have filed lawsuits and most of the assets have been lost. The involuntary bankruptcy petition is a preemptive move, allowing the creditors to take control of the situation at an earlier time.

The most important feature of the involuntary bankruptcy proceeding is the ability to control the debtor's assets. This control comes in two forms. First, the assets are frozen in place at the time of the order for relief and the debtor is forbidden from making payments or transferring funds without approval. All of the debtor's assets and interests, including those that arise after the commencement of the case, become part of the bankruptcy estate.

More importantly, the bankruptcy court has the power to set aside certain transfers of assets made before the petition was filed, often referred to as preferences. This includes transfers within 90 days of the filing of the petition, made for the benefit of a creditor on an existing debt, while the debtor was insolvent. This is a powerful tool, particularly when the subcontractor has used funds the general earmarked for a material supplier to pay off other creditors within the 90 day period. The bankruptcy trustee can bring that money back into the estate and use it for the benefit of all creditors.

Finally, filing the petition may ultimately aid the debtor. A central purpose of the Bankruptcy Code "is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt'." But many people are understandably concerned about approaching the bankruptcy courts for relief, and bankruptcy carries a stigma that most people associate with failure and destitution. Debtors frequently view it as a last resort, wait too long to go to the bankruptcy court, exhaust their assets and end up insolvent. If creditors file for involuntary bankruptcy before the end is near, the debtor has a better chance for reorganization under Chapter 11 because it will have a chance to formulate a plan for reorganization without the pressures of bill collectors. An established subcontractor may have the goodwill and reputation to rebuild following discharge of a Chapter 11 case.

Enforcing Other Claims Against the Debtor

Frequently, the general contractor has issues to resolve with its subcontractor beyond the failure to pay material suppliers; there may be substantial breach of contract claims to resolve related to performance and delay that will require litigation. Those claims can also be addressed during the bankruptcy proceedings that follow the order for relief.

Unlike the involuntary bankruptcy petition, during bankruptcy the court recognizes all types of claims, including any right to payment, whether reduced to judgment, liquidated, unliquidated, fixed, contingent, or disputed. While there must be a liquidated aggregate amount to file the petition, any other disputed claim can also be filed. The court will settle disputed claims during the course of the bankruptcy case, either through negotiation or litigation. The contractor can pursue its breach of contract action, just as it would be outside the bankruptcy proceedings.

Using involuntary bankruptcy may not work in every circumstance, but it can be a powerful tool in those situations where a subcontractor has failed to pay material suppliers on a project and is facing insolvency. The general contractor can take control of the debtor's financial situation, and prevent additional loss of debtor's assets. Although this option may be viewed as an aggressive remedy, in the end it may help the subcontractor get back on its feet and allow the general contractor to recover more than it could through more common remedies.

—Douglas M. McManamon ❖

Regulation of Consumer Credit Reports

Credit reports can be a goldmine of information for builders and their lawyers. Does a prospective client pay his bills? What is the creditworthiness of a prospective business partner? Is a prospective employee trustworthy? Does a potential defendant have deep pockets? What creditors are competing for the pocketbook of a judgment debtor? But, watch out! Complex federal and California laws govern the use of credit reports and other reports on consumers, and violations can result in private lawsuits for punitive damages, civil enforcement actions —even criminal prosecution.

In California, the federal Fair Credit Reporting Act (FCRA), the California Consumer Credit Reporting Agencies Act (CCRAA), and the California Investigative Consumer Reporting Agencies Act (ICRAA) are the leading statutes that govern the use of consumer reports. As many people would expect, these statutes regulate reports that address a subject's creditworthiness, but they *also* regulate reports on a subject's "character, general reputation, personal characteristics or mode of living," all of which are matters into which builders and their lawyers may want to inquire. (15 USC § 1681a(d)(1); California Civil Code § 1786.2(c); California Civil Code § 1785.3(c).) These statutes are too complex to parse fully here, but a few salient principles are worth noting.

First, Federal and California laws regulate reports concerning individuals. Thus, if the subject of a report is a corporation, a limited liability company, a limited partnership, a limited liability partnership, or a partnership, then a builder and the builder's lawyer can procure a report from a credit reporting agency without risking civil or criminal liability under the FCRA, CCRAA, or the ICRAA.

Second, although federal and California law govern reports concerning an individual's character, general reputation, and mode of living, the regulations do not govern a report unless it contains information that was gathered or will be used or is expected to be used: (a) to establish the consumer's eligibility for credit (or insurance): (b) "to be used primarily for personal, family or household purposes" or (c) for employment purposes.

Third, a builder or his lawyer may procure a consumer report with written permission from the subject of the report.

Finally, a builder or a builder's lawyer, like any other seller of goods and services, can use a consumer report in connection with collecting a client's outstanding balance due for legal services.

There are also some situations where a builder or a builder's lawyer can use credit reports with certain caveats.

- To gain information regarding a prospective defendant in an action to collect a balance due for work already performed or goods already sold. However, the builder or the builder's lawyer may, depending on the nature of the report, have to satisfy certain disclosure requirements.
- To obtain information regarding a judgment debtor once an award has been entered. Again, the builder or the builder's lawyer may have to satisfy certain disclosure requirements.
- To gain information on a potential client before extending credit to or accepting checks from a client. And again, certain disclosures may be required of the builder or the builder's lawyer. To minimize his or her exposure to liability, the builder or the builder's lawyer should first obtain written permission from a prospective client before running a credit check, resorting to a check verification service, or obtaining any other consumer report for a credit reporting agency.

There are also a few purposes for which a credit report should clearly *not* be used:

- To locate a potential witness in a lawsuit by means of a consumer report prepared by a "credit reporting agency." A credit reporting agency is, in a nutshell, "any person which, for monetary fees . . . regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of

furnishing consumer reports to third parties . . . ." However, according to the FTC, a report "limited solely to the consumer's name and address alone" does not qualify as a regulated consumer report. Therefore, requesting a report that contains no more than a name and address is possibly a lawful means of locating a witness, even if a credit reporting agency provided the report.

- To determine whether a potential defendant of a tort claim has deep pockets.
- To determine whether a defendant of a contract claim can pay the claim, unless judgment has already been entered.
- For the purpose of cross-examining a witness.
- Again, depending on the nature of the report, certain disclosure requirements may apply. However, neither a builder nor a builder's lawyer should procure reports on individual owners of a corporate client, unless the individuals have specifically stated that they would be responsible for the legal bills of the corporate client.
- A builder or a builder's lawyer may also use a credit report or investigative consumer report for employment purposes, including hiring, promotion, and termination. However, the builder or the builder's lawyer must satisfy several disclosure and consent requirements in conjunction with procuring and using consumer reports for employment purposes.
- Finally, builders and lawyers should be careful when they retain private investigators. In the course of litigation, builders and their lawyers frequently consult investigators to find a missing witness, answer questions about a witness's credibility, or locate an opponent's assets. Again, builders and their lawyers should be wary of running afoul of the FCRA, CCRAA, and ICRAA because, under some circumstances, a private investigator's report may fall within their regulatory scope. Nevertheless, a builder and the builder's lawyers should, under many circumstances, be able to order a private investigator's report without liability so long as (a) the investigator does not rely upon information that that has been ". . . collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for" credit or insurance "to be used primarily for personal, family or household purposes" or employment purposes (e.g. a credit report from TRW) and (b) the report does not concern an individual who "has made application to a person for employment purposes, for insurance for personal, family, or household purposes, or the hiring of a dwelling unit." To minimize potential liability, a builder or the builder's lawyers should, before engaging a private investigator, inquire whether the investigator's report will draw upon consumer reports that may fall within the regulatory scope of the FCRA, CCRAA, or ICRAA.

> COMPLEX FEDERAL AND CALIFORNIA LAWS GOVERN THE USE OF CREDIT REPORTS AND OTHER REPORTS ON CONSUMERS, AND VIOLATIONS CAN RESULT IN PRIVATE LAWSUITS FOR PUNITIVE DAMAGES, CIVIL ENFORCEMENT ACTIONS – EVEN CRIMINAL PROSECUTION.

—Anthony L. Critchlow ❖

NEWS AT BR&H

BR&H is pleased to welcome Anne Stefanakis as the firm's new Executive Director. Anne brings a wealth of management experience in the legal and business worlds, and she is instituting a number of bright innovations to keep Bell, Rosenberg & Hughes on the cutting edge of professional practice. We are also happy to introduce Dylan A. Hendricks and Chijeh Hu as new associates with the firm this fall.

To meet all of the attorneys and staff members at BR&H, and to learn more about the firm and its resources, please visit us at **www.brhlaw.com.**

Bell, Rosenberg & Hughes LLP
1300 Clay Street, Suite 1000
P.O. Box 70220
Oakland, California
94612–0220
(510) 832-8585
www.brhlaw.com

FIRST CLASS MAIL
US POSTAGE
PAID
BERKELEY CA
PERMIT NO. 559

San Diego
8880 Rio San Diego Drive
Suite 800
San Diego, California 92108
(619) 209-6110 phone
(619) 209-6111 fax

Breakfast Forum: Green Construction

Find out how building green can benefit all participants in the development and construction industries.

Friday, October 21, 7:30 A.M.

NEW LOCATION:

Scott's Restaurant, Jack London Square, Oakland

For more information and RSVP options, please see page 5.

Firm Overview

Bell, Rosenberg & Hughes LLP provides a full range of expert counsel to the construction industry, from contract negotiations to dispute resolution to aggressive litigation. Our clients are building some of the biggest and most important projects in the country, and we are helping them every step of the way. For 35 years we have enjoyed an international reputation for excellent service, effective representation, and integrity. We have unparalleled expertise in all aspects of construction law and business practice including dispute resolution, real estate development, insurance coverage, trusts and estates, and business succession planning.

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Partners

John H. Banister
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Roger M. Hughes
Teresa Jenkins Main
Roland Nikles
Eric J. Phillips
Robert Rosenberg
Carol K. Watson

Of Counsel

Howard Bell
Jim Nelson

Associates

Shira Bobrove
Chris Carrillo
Kimble Cook
Anthony Critchlow
Raymond Kong
Douglas McManamon
James Melino

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