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BUILDING SOLUTIONS

Reflections On The False Claims Act In The Wake Of *Universal Health*

by Robyn N. Burrows, Associate

Introduction

Over a year ago in June 2016, the Supreme Court in *Universal Health Servs. v. United States*, 136 S. Ct. 1989 (2016) upheld the implied certification theory of liability under the federal False Claims Act ("FCA") while also laying the groundwork for a demanding materiality standard. *Universal Health* has had major implications on lower courts analyzing claims based on the implied certification theory. Although many courts have permitted cases to proceed under this theory based on the Supreme Court's reasoning, many others have applied *Universal Health*'s materiality standard to cabin the scope of the FCA and ensure it is narrowly targeted to prevent fraud, rather than used as a tool to punish mere regulatory violations. In analyzing materiality, courts have focused on whether the agency took any action in response to the alleged fraud, whether the fraud went to the "heart of the bargain," and the contractor's incriminating behavior in covering up its non-compliance.

Implied Certification And *Universal Health* On Remand

The theory of implied certification posits that contractors submitting a claim for payment implicitly certify compliance with all applicable statutes, regulations, and contract terms. Contractors may be found liable for fraud if they submit a claim while not in compliance with these requirements. The implied certification theory was tested in *Universal Health* when parents brought an FCA claim against a healthcare clinic after their daughter died while under the care of unlicensed clinic staff, claiming that the clinic failed to comply with state regulations governing qualifications and supervision of staff members. The Supreme Court endorsed implied certification but clarified the standards, holding that a contractor may be liable under the theory when it makes specific representations about the goods or services provided, but knowingly fails to disclose noncompliance with a statutory, regulatory, or contractual requirement. Such noncompliance must be measured against a "demanding" materiality standard, which considers, among other things, whether the government would have paid for the claims had it known about the noncompliance.

After validating the implied certification theory, the Supreme Court remanded the case to the First Circuit to determine whether the relators had sufficiently pleaded an FCA violation. The First Circuit held that the healthcare provider's misrepresentations met the "demanding" materiality standard developed by the Supreme Court. Notably, the court interpreted *Universal Health* as mandating a "holistic approach" to determining materiality, finding that "materiality cannot rest 'on a single fact or occurrence as always determinative.'" The court also noted that materiality is more likely to be found "where the information at issue goes 'to the very essence of the bargain.'" Based on that standard, the court had "very little difficulty" in finding the healthcare provider's misrepresentations to be material. Not only was regulatory compliance a condition of payment, but the licensing and supervision requirements in the regulatory program went to the "very essence of the bargain." Thus, a failure to comply would influence the government in deciding whether to pay the claims.

Applications of *Universal Health*

Several courts re-visited their decisions in light of the Supreme Court's holding in *Universal Health*. For example, prior to *Universal Health*, the Fourth Circuit in *United States v. Triple Canopy, Inc.*, 857 F.3d 174 (4th Cir. 2017) found FCA liability against a security firm which falsified its guards' marksmanship scorecards to conceal its failure to meet the standards under the contract. After *Universal Health*, the Fourth Circuit affirmed its decision on the basis of implied certification, finding that its analysis was consistent with the Supreme Court's opinion. Although the contractor argued that *Universal Health* required "specific representations" about the services above and beyond simply submitting invoices listing

the number of guards and hours worked, the court disagreed, claiming that the "rule is not as crabbed" as the contractor claimed. Rather, such "half-truths" are sufficient to incur liability. The court was guided by both "common sense" and incriminating evidence that the contractor had attempted to cover-up its noncompliance.

Decisions post-*Universal Health* also reveal that the government's decision to continue paying claims after learning about alleged fraud will strongly weigh against a finding of liability. For example, a former employee alleged that a drug manufacturer falsely represented to the FDA that an anti-cancer drug was "reasonable and necessary" for certain at-risk Medicare patients by suppressing information about side-effects which would have caused doctors to prescribe a lower dose, thus ultimately saving the government money. *United States ex rel. Petratos v. Genentech Inc.*, 855 F.3d 481 (3d Cir. 2017). Relying on the *Universal Health* materiality standard, the Third Circuit held that the relator could not establish materiality because he had *conceded* that the government would have paid the claims even with full knowledge of the alleged noncompliance. This fact alone "doomed" the relator's case.

Courts analyzing materiality after *Universal Health* have also considered whether the agency took action upon learning about the alleged non-compliance. In *United States v. Sanford-Brown, Limited*, 840 F.3d 445 (7th Cir. 2016), the relator alleged that a college fraudulently retained students which would have rendered the school ineligible to receive federal subsidies. In rejecting liability, the Seventh Circuit found it persuasive that federal agencies had investigated the school several times and concluded that neither administrative penalties nor termination was warranted. At most, the relator's allegations showed that the government could have declined payment due to the noncompliance, which was clearly insufficient to trigger liability under *Universal Health*.

The First Circuit similarly rejected liability based on the FDA's inaction in the face of knowledge of a contractor's alleged fraud. Several doctors claimed that an artificial hip manufacturer falsely secured FDA approval for a defective product by asserting that the product was equivalent to a previously approved product and had an artificially low failure rate. *United States ex. rel Nargol v. Depuy Orthopaedics, Inc.*, No. 16-1442, 2017 WL 3167622 (1st Cir. July 26, 2017). The court rejected this theory of fraud because the FDA never withdrew its approval for the product, even after it was made aware of the doctors' claims. The court considered this fact to be a "break in the causal chain between the alleged misstatements and the payment of any false claim," thus rendering "a claim of materiality implausible." The court, however, imposed liability on alternative grounds based on the company's fraudulent scheme whereby it "palmed off" the defective product on unsuspecting doctors who in turn submitted claims for payment.

In contrast to the above cases, the Ninth Circuit found a drug company liable for making false statements to the FDA about its compliance with regulations, despite the FDA *continuing* to approve the drug. *United States ex rel. Campie v. Gilead Sciences, Inc.*, No. 15-16380, 2017 WL 2884047 (9th Cir. July 7, 2017). The drug company acquired an unapproved ingredient from a Chinese supplier, re-labeled it to conceal its true nature, falsified test results that showed it was contaminated, and then used the ingredient in drugs for which payment was requested and received. The court imposed liability under implied certification based on the company's submitting claims for reimbursement for drugs that were adulterated and misbranded. Although the FDA continued to reimburse claims after learning about the company's non-compliance, the court determined that the FDA's continued approval was not dispositive and refused to allow the company to rely upon its fraudulently-obtained FDA approval as a shield to FCA liability. Like the Fourth Circuit in *Triple Canopy*, the court also pointed to the various steps the company took to perpetuate its fraud, including altering results, batch numbers, and claiming the ingredient came from approved facilities.

Courts have also been careful to scrutinize the connection between the alleged false statement and the resulting increase in cost to the government. For example, a former employee alleged that a contractor providing recreational facilities for the military inflated "headcount" data which purported to track how many troops frequented its recreation centers. *United States ex rel. McBride v. Halliburton Co.*, 848 F.3d 1027 (D.C. Cir. 2017). Like other courts, the D.C. Circuit noted that the investigating agency had reviewed these allegations but never disallowed or challenged any of the amounts the contractor had billed for services. Further, the government did not require headcount data to be maintained or produced—the contractor voluntarily undertook to track this data. Although the relator claimed that the contractor inflated headcounts to justify higher staffing which would increase personnel costs, there was no evidence that staffing was excessive. Without a connection between headcounts and cost, the court determined

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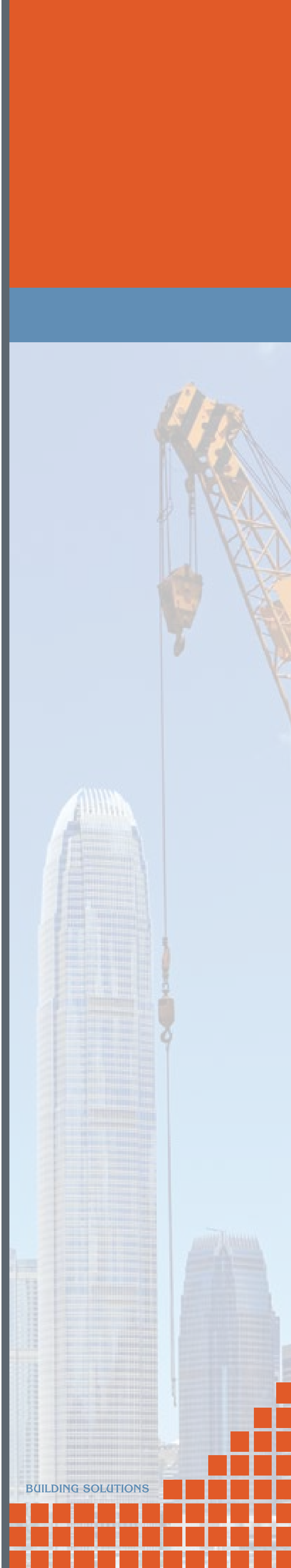

that false headcounts could not be relevant or material to the government's decision to pay.

Conclusion

As courts continue to interpret *Universal Health*, contractors will better understand the confines of implied certification and the type of actions that may potentially trigger FCA liability. Although the continued vitality of implied certification may cause concern for contractors, it is clear that courts post-*Universal Healthcare* have applied this theory in light of the Supreme Court's insistence upon a "demanding" materiality standard.

PAYMENT BONDS

Payment Bond Defenses: To Pay Or Not To Pay, That Is The Question

by Lauren E. Rankins, Erica Del Aguila and Aniuska Rovaina, Associates

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Introduction

This article's analysis begins with a maxim that is the very essence of suretyship – the surety is not liable unless its principal is liable on the underlying obligation. As such, a surety is entitled to assert its principal's defenses against a claim for labor or material furnished to the bonded project. This general rule is true even if the principal does not assert the defenses itself or is barred from doing so by an unrelated legal disability. The surety may not, however, maintain a defense that has already been waived by the principal nor may the surety assert the "personal" defenses of its principal, such as bankruptcy, infancy, insanity, or duress. Further, the surety's ability to assert its principal's defenses may be impacted when dealing with second-tier claimants.

Additionally, a surety may also assert defenses that are unique to itself as a surety. However, a surety's defenses to a performance bond claim, such as owner/obligee default, will not likely defeat an unpaid subcontractor or supplier's payment bond rights because a payment bond claimant has distinct rights under the payment bond that are defined by its own contract and conduct. With all of this being said, it is important that the surety conduct an independent and objective investigation to determine whether it has the factual, contractual and legal authority to assert such defenses. Below is a general overview of only some of the defenses that may be available to a payment bond surety.

Material Breach

A claimant's material breach of its contract may serve as a complete defense to a payment bond claim. A material breach may occur if the claimant unjustifiably abandons the project, fails to reach substantial completion, or fails to perform its work in accordance with the contract documents. However, this defense may fail if the claimant's performance under its contract is executed by the principal's own prior material breach, i.e., nonpayment, wrongful termination, etc.

Recoupment Or Setoff

Generally speaking, a surety may setoff against a first-tier claimant any costs incurred by its principal to complete or remediate claimant's work and any costs incurred as a result of the claimant's delay. But, authorities differ on a surety's setoff rights against a second-tier claimant. Some courts have found that the principal is not barred by the lack of privity from recouping its corrective expenses because the second-tier claimant may only recover for "sums justly due." *See United Structures of America v. G.R.G. Eng'g*, 9 F.3d 996 (1st Cir. 1993). However, other courts have found that a surety may not charge correction and delay damages against a second-tier claimant because of the lack of privity between the principal and the second-tier claimant. *United*

States ex rel. Martin Steel Constructors v. Avanti Constructors, 750 F.2d 759 (9th Cir. 1984).

Payment

Payment may also serve as a defense to a payment bond claim. However, this defense will only hold up if actual payment is made and received. In other words, a promissory note or bounced check will not discharge the surety of its bonded obligations.

Contingent Payment Clauses

Sureties may also assert contingent payment clauses as a defense of their principals in order to shift the risk of non-payment by project owners to subcontractors. Contingent payment clauses generally fall into two categories: Pay-When-Paid clauses and Pay-If-Paid clauses.

Pay-When-Paid clauses provide that a contractor will pay its subcontractor within a certain amount of time after receiving payment from the owner. Pay-When-Paid clauses serve as a timing mechanism that postpone a contractor's payment obligations to its subcontractors, but do not shift the entire risk of owner non-payment to subcontractors.

On the other hand, Pay-If-Paid clauses make payment by an owner to a contractor a condition precedent to a contractor's payment to its subcontractor, thereby shifting the risk of non-payment entirely to a subcontractor. Pay-If-Paid clauses will generally be enforced only if the language in the contract makes it expressly and unequivocally clear that the parties intended the contract to include the Pay-If-Paid condition precedent. Additionally, some states have enacted statutes that prohibit the enforcement of Pay-If-Paid clauses as void against public policy.

Contingent payment clauses will not be enforced or considered as a valid defense where a principal is the cause for the non-payment or delay in payment from the owner. Notably, some jurisdictions have also found that sureties may not raise contingent payment clauses as a defense unless they expressly incorporate the terms of their principal's subcontractors into the terms of the bond.

No-Damages-For-Delay Clauses

No-Damages-for-Delay clauses prevent a subcontractor from recovering delay damages against a contractor. Delays in construction are not uncommon and therefore, these provisions serve as a tool for allocating the costs for delays between the parties. However, courts across the majority of jurisdictions have recognized the following exceptions to the enforceability of No-Damages-for-Delay clauses: (i) bad faith or other misconduct by the contractor; (ii) active interference (an affirmative or willful act) interfering with a subcontractor's work; (iii) a delay that is so unreasonable that the delayed party could have abandoned the project; (iv) a delay not contemplated by the parties at the time of their agreement and which lies beyond the contractor's intended scope; and (v) a delay caused by the contractor's gross negligence. This is a non-exhaustive list of exceptions, as they are highly fact specific and vary on a cases-by-case basis and by jurisdiction.

Waiver, Estoppel And Other Related Defenses

Another set of defenses available to sureties are those in which the claimant surrenders rights that were previously available to the claimant either through novation, a wavier or equitable estoppel.

For the defense of novation, the parties agree to replace the terms of the original agreement with a second agreement, which ultimately extinguishes the obligations under the original agreement. Typically, to effectuate novation of a binding agreement, there must be: (i) a previously valid contract; (ii) an agreement between the parties to cancel the previous contract; (iii) a new valid and binding contract; and (iv) an agreement between the parties that the new agreement will replace and extinguish the old agreement. The assent to the second agreement would then release the parties from any liability under the previous agreement. Consequently, a new agreement between a contractor and a subcontractor will also release the surety from its obligations or liabilities under the former agreement.

A second method by which a claimant may forgo previously held rights is through the execution of a waiver. A claimant can waive its payment bond rights by entering into a written agreement with the parties to the payment bond. The Miller Act considers a waiver of a civil action on payment bond to be valid so long as the waiver is: (i) in writing; (ii) signed by the person whose rights are waived; and (iii) executed after the person whose rights are waived has furnished labor or material outlined in the construction contract. Thus, a claimant cannot waive its payment bond rights prior to supplying labor or materials. For this reason, some jurisdictions find that waiver provisions contained in construction contracts are unenforceable.

Finally, a claimant may lose its payment bond rights due to its own actions. Under the doctrine

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of equitable estoppel, if a claimant conceals facts or makes false misrepresentations to the principal or its surety, and knows the other party will rely on such statements, then the claimant's assertion for damages against the principal and its surety may be barred. In order for a surety to assert estoppel, the following elements must be met: (i) the claimant actually or constructively knew the material facts the other party relied upon; (ii) the claimant intended for the other party to rely on the concealed facts or misrepresentation; (iii) the contractor or surety did not know or have means to know the material facts; and (iv) the contractor or surety acted to its detriment on the claimant's misrepresentation.

Conclusion

When a payment bond claimant makes a timely and proper payment bond claim, the surety must conduct an independent and objective investigation to determine whether such demanded monies are truly owed to the claimant. The surety's investigation should include a thorough review of the underlying contract, the payment applications, invoices, schedules, project correspondence, meeting minutes, etc. The surety should also seek an understanding of the nature of the project and the claimant's work on the project, because if the claimant caused delays or if its work is defective, it may be a partial or total defense to the bond claim. The surety's investigation must not be hasty and may require the assistance and advice of counsel or a consultant to ensure that the surety's analysis of the claimant's payment bond claim is comprehensive. So, to pay or not to pay, the results of the surety's investigation should answer that question.

CALIFORNIA UPDATE

Owners And General Contractors Beware: California's New Limits On Design Professional's Defense And Indemnity Obligations Require Increased Scrutiny Of All Construction Indemnity Provisions

by Jane G. Kearl, Partner

Following a nationwide trend of states disfavoring indemnity provisions, this spring California passed into law a measure strictly limiting the ability to require defense and indemnity from a design professional, including licensed architects and registered engineers. Effective July 1, 2018, owners will no longer be able to demand broad indemnity obligations from design professionals, but rather, will be limited to a proportionate percentage of fault standard. Given this new limitation, owners and general contractors will need to carefully scrutinize all indemnity provisions to ensure there are no gaps in indemnity and defense coverage.

As amended, under the new law, California Civil Code Section 2782.8, the professional's defense and indemnity obligations will be enforceable only "to the extent that the claims against the indemnitee arise out of, pertain to, or relate to the negligence, recklessness or willful misconduct of the design professional." Further, the design professional's defense obligation may not exceed "the design professional's proportionate percentage of fault," with an exception if another defendant is bankrupt or the business is dissolved. Rather than a pro rata increase in defense costs in such a situation, however, the only remedy provided by the new law is that the design professional "shall meet and confer with other parties regarding unpaid defense costs." The statute does not address the consequences of failing to agree on the apportionment after such a meet and confer.

Also unclear is whether the duty to defend may still arise at the time of tender, subject to this right of reimbursement. The author of the law states that the new law "preserves the design professional's 'uninsurable' first-dollar defense indemnity obligation while no longer exposing them to unlimited liability" (SB 496, Senate Rules Committee Analysis, quoting author

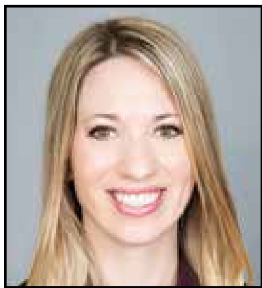
(2017)). Whether the courts will recognize this legislative intent or will require a determination of liability prior to the imposition of defense obligations, however, remains to be seen. Given that most professional liability policies for design professionals do not include coverage for third party up front defense costs, this remnant of the existing law may be of cold comfort in the practical aspect of contract negotiations.

The limitations of the new law will not apply to design professional contracts where: (1) a project specific general liability policy insures all project participants for general liability exposure on a primary basis and also covers all design professionals for their legal liability arising out of their professional services on a primary basis; (2) the design professional is a party to a written design-build venture agreement; or (3) the contract is with a state agency.

Given this further venture by California down the anti-indemnity path, owners and general contractors will want to review all construction related agreements prior to the new law's effective date. Design professional master agreements should be reviewed and amended as necessary as indemnity clauses will be unenforceable except as permitted by the new law, which is "deemed to be incorporate[d] by reference" into all contracts and solicitation documents after the effective date. The other indemnity requirements of Civil Code Section 2782 (for construction contracts in general, subcontractors and general contractors) should also be evaluated in light of the new law. Owners and general contractors will want to consider these indemnity limitations in negotiations with all parties involved with a project to ensure a cohesive, yet enforceable, net of protection.

Who Can You Tell? Untangling The Attorney-Client Privilege In California

by Amanda L. Marutzky, Associate and Emma Peplow, Law Clerk



Amanda L. Marutzky

Introduction

"I want to speak to my attorney." This is one of the most common phrases repeated on crime television shows, but what does it really mean? Most people think of communications with their lawyer as a form of absolute protection. But in reality, the privilege is easily waived. For this reason, whether acting as a client, an attorney or a third party listener, it is vital to understand the meaning and scope of the attorney-client privilege.

There are two primary forms of attorney-client privilege in California: confidential communication and the attorney work-product doctrine. For communication between an attorney and client to be privileged, the information must be communicated "for the purpose of retaining the lawyer or securing legal service or advice from him in his professional capacity." Cal. Evid. Code §951. Conversely, the attorney work-product doctrine renders communications confidential if they constitute "a writing that reflects an attorney's impressions, conclusions, opinions, or legal research or theories [which are] not discoverable under any circumstances." Cal. Civ. Proc. Code §2018.030. The doctrine specifies that the *content* of the communications between an attorney, client, and third party can be a determining factor in its privileged status. To overrule the absolute privilege invoked by this type of communication, the court must "determine[] that denial of discovery will unfairly prejudice the party seeking discovery in preparing the party's claim." Cal. Civ. Proc. Code § 2018.030(b).

What If The Communication Is Between An Attorney, Client And Consultant?

Where a communication is between an attorney, client and third party consultant or construction manager, the privilege hinges upon two main factors: a) the role the third party plays in the ongoing case, and b) the content of the communications. Attorney-client privilege is preserved in the presence of a third party as long as the third party is acting as an agent or channel of information between the attorney and client and the disclosure is "reasonably necessary for the transmission of information or the accomplishment of the purpose for which the lawyer is included, and includes a legal opinion formed and the advice given by the lawyer in the course of that relationship." Cal. Evid. Code §952; *see also* Cal. Evid. Code §912(d). Disputes often arise over the question of whether the third party presence was "reasonably necessary." To prove that a communication is "reasonably necessary," the third party must

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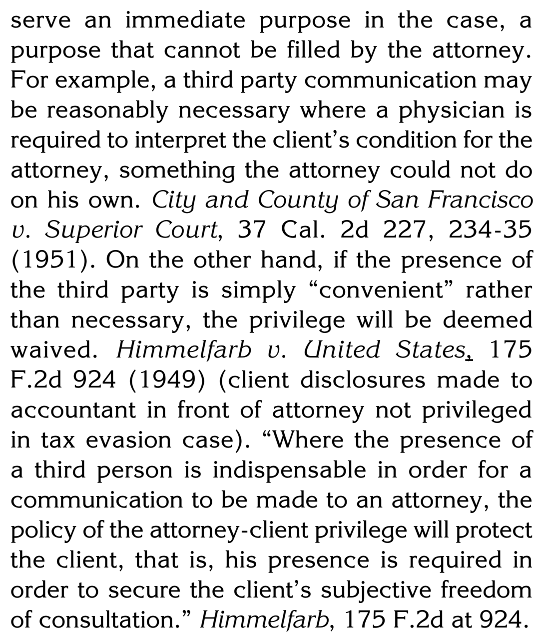


serve an immediate purpose in the case, a purpose that cannot be filled by the attorney. For example, a third party communication may be reasonably necessary where a physician is required to interpret the client's condition for the attorney, something the attorney could not do on his own. *City and County of San Francisco v. Superior Court*, 37 Cal. 2d 227, 234-35 (1951). On the other hand, if the presence of the third party is simply "convenient" rather than necessary, the privilege will be deemed waived. *Himmelfarb v. United States*, 175 F.2d 924 (1949) (client disclosures made to accountant in front of attorney not privileged in tax evasion case). "Where the presence of a third person is indispensable in order for a communication to be made to an attorney, the policy of the attorney-client privilege will protect the client, that is, his presence is required in order to secure the client's subjective freedom of consultation." *Himmelfarb*, 175 F.2d at 924.

Under the attorney work-product doctrine, third party communications that might not otherwise be considered privileged *become privileged* when met with "an attorney's impressions, conclusions, opinions, or legal research or theories." *See Coito v. Superior Court*, 54 Cal. 4th 480 (2012). For example in *Coito,* recorded witness interviews were deemed worthy of absolute privilege on the grounds that "a witness's statements are inextricably intertwined with explicit comments or notes by the attorney stating his or her impressions of the witness, the witness's statements, or other issues in the case." *Id.* Notwithstanding, the presence of a third party can lead to the client inadvertently waiving her privilege, regardless of whether the content of the communication was privileged. *D. I. Chadbourne, Inc. v. Superior Court*, 60 Cal. 2d 723 (1964). *Chadbourne* states that "even where a communication is privileged in the first instance, the privilege may be waived by failure to maintain confidentiality. Where the client communicates with his attorney in the presence of other persons who have no interest in the matter, or where he communicates in confidence but later breaches that confidence himself, he is held to have waived the privilege." Thus, the indispensable nature of the relationship between the case and the third party must be proven to assert privilege.

The burden of proof lies with the party claiming the privilege. *Wellpoint Health Network, Inc., et. al. v. Superior Court*, 59 Cal. App. 4th 110 (1997). The party claiming privilege has to demonstrate both the third party's purpose in the case and how this purpose is vital to ensuring that the attorney can fulfill their duties to the fullest extent and "further the interest of the client in the consultation." Cal. Evid. Code § 952.

What If The Communication Is Only Between An Attorney And A Consultant?

The privilege can still be asserted where communications are only between an attorney and a consultant (and the client is not present). The courts have reasoned that "the communications of the attorney's agent to the attorney are within the privilege, because the attorney's agent is also the client's sub-agent and is acting as such for the client." *City and County of San Francisco*, 37 Cal. 2d at 234-35. Similarly, reports and materials provided by an expert or consultant to the attorney are considered privileged until the consultant officially becomes a witness. *See Shadow Traffic Network v. Superior Court*, 24 Cal. App. 4th 1067 (1994); *Armenta v. Superior Court*, 101 Cal. App. 4th 525 (2002). Once the consultant is designated as a witness, "the opponent may seek disclosure of the reports upon showing good cause. [But if the] reports embrace counsel's impressions and conclusions, the work-product doctrine gives absolute protection to that information." *Shadow*, *supra*.

A consultant's notes may also be included in the work-product doctrine. *Richard Rodriguez, et al. v. McDonnell Douglas Corporation*, 87 Cal. App. 3d 626 (1978) overruled on other grounds in *Coito*, 54 Cal. 4th at 480. In *Rodriguez*, a defense attorney's investigator's notes were improperly admitted since they included the investigator's privileged comments. *Id.* Even if the notes are based on a non-privileged topic, if they are "intertwined" with the agent or attorney's observations, opinions, or thoughts on the case, the notes as a whole are inadmissible. *Id.*; *see also Zerlene Rico v. Mitsubishi Motors Corp.*, 42 Cal. 4th 807 (2007)(firm dismissed from case due to use of documents that included privileged notes from opposing counsel).

What If The Communication Is Only Between A Client And A Consultant?

When analyzing communications between a client and a consultant without the presence of an attorney, asserting privilege depends on the role the third party plays in the case. "A lawyer at times may desire to have a client reveal information to an expert consultant in order that the lawyer may adequately advise his client. The inclusion of the words 'or the accomplishment of the purpose for which the lawyer is consulted' assures that these communications too are within the scope of privilege." 7 Cal. L. Rev. Comm. Reports 1 (1965). Moreover, "a disclosure in confidence of a communication that is protected by a privilege provided by Section 954 (lawyer-client privilege) [...], when disclosure is reasonably necessary for the accomplishment of the purpose for

which the lawyer [...] was consulted, is not a waiver of privilege." Cal. Evid. Code §912(d). Notwithstanding this interpretation of the Code, there is little case law supporting privilege as to communications between a consultant and client. And, as demonstrated in *Chadbourne*, even previously privileged confidential material, if later communicated between a client and consultant, can result in a waiver. Thus, direct communications between clients and consultants without an attorney should be carefully scrutinized with added caution if the communications include sensitive information.

How Do I Keep My Correspondence Privileged?

The safest way to communicate with and among attorneys, clients, and consultants is to: a) have the attorney present at all times as to not inadvertently waive privilege by breaching confidentiality; b) utilize the work-product doctrine; and c) keep to a minimum the amount of consultants or third parties allowed into attorney-client discussions.

Circumstances for privilege between a client and consultant are few. There are more options and justifications for privilege if an attorney is present. Communications between all three parties can be protected given the "indispensable" nature of the consultant or the showing of two separate privileged communications -- one between attorney and consultant and one between attorney and client. Either way, the simplest route is to always have the lawyer present.

When having a lawyer present is unrealistic, the work-product doctrine can be a powerful tool. Due to the broad definition of work-product set forth in *Coito*, it is clear that communications intertwined with attorney work-product are subject to absolute privilege. Most communications between attorneys and either clients or consultants include at least a few intertwined observations or impressions, either explicit or implicit, akin to case theories, lines of inquiry or question selection. In order to create and maintain a work-product privilege, attorneys' clients and consultants should seek to include those "attorney impressions, conclusions, opinions, legal research or theories" in each of the communications exchanged, including email threads.

Attorneys and clients who wish to keep their correspondence privileged should also attempt to limit the number of third parties involved in attorney-client communications. Be careful who and how many people you "cc" in your case emails. Adding too many non-essential parties to the privileged discussion could be interpreted as a breach of confidentiality and would subsequently waive the client's privilege. Remember in order to involve a third party, the client has to be able to prove that "[the third party's] presence is required in order to secure the client's subjective freedom of consultation." *Himmelfarb, supra*. The more parties involved, the more difficult it becomes to prove each third party's presence is "required," thus jeopardizing the attorney-client privilege.

SECURITY INTEREST

Don't Wait Until It's Too Late: Start Thinking About The Security Interest Clauses In Your Contracts

by Marguerite Lee DeVoll, Associate

Congratulations! You just executed a contract. The contract may be a general indemnity agreement ("GIA"), a lease for office space or equipment, or a loan document for financing a construction projection. Regardless of the reason for the contract, it likely contains a clause titled "Security Interest" with language similar to the following:

> As security for their obligations hereunder, Person A hereby grants Person B a security interest in the following properties, assets and rights of Person A, wherever located, whether now owned or hereafter acquired or arising, and all proceeds and products thereof: all goods (including inventory,

...continued on page 10

> equipment and any accessions thereto), instruments (including promissory notes), documents, accounts, chattel paper, deposit accounts, letter-of-credit rights, securities and all other investment property, supporting obligations, any contract or contract rights or rights to the payment of money, insurance claims and proceeds, and all general intangibles (the "Collateral"). This Agreement shall for all purposes constitute a Security Agreement for the benefit of Person B in accordance with the Uniform Commercial Code ("UCC") and all similar statutes. Person A hereby irrevocably authorizes Person B, without notice to Person A, in order to perfect the security interest granted herein, to file either: (a) this Agreement or a copy or other reproduction of this Agreement; or (b) any initial financing statements or amendments thereto that indicate the Collateral as all assets of Person A or words of similar effect, as being of an equal or lesser scope or with greater detail and that contain any other information relating to Person A required by Part 5 of Article 9 of the UCC for the jurisdiction where such financing statement or amendment is filed. Person B may add schedules or other documents to this Agreement as necessary to perfect its rights. The failure to file or record this Agreement or any financing statement shall not release or excuse any of the obligations of Person A under this Agreement.

Language of this type is intended to give the secured party (*i.e.*, the surety, landlord, or lender) an interest in the debtor's (*i.e.*, the indemnitor's, tenant's, or borrower's) personal property. Simply reciting the language, however, does not protect the secured party against competing claims by other parties with an interest in the same property ("Secured Parties"). As discussed below, more action is required. Too often the beneficiary of the security interest clause waits until there is a breach of contract or other default before looking into the security interest clause and taking advantage of its protections. By then, the benefits and protections of a security interest clause may have significantly diminished.

Follow The Rules: The UCC And Revised Article 9

While laws vary from state to state, all states have adopted a version of Revised Article 9 of the Uniform Commercial Code ("UCC"). Revised Article 9 lays out the ground rules for secured parties, their security interests, and how to enforce security interests. While some of the same rules apply regardless of the type of property that is subject to the security interest (*e.g.*, real property, fixtures, or personal property) other rules are dependent on the specific property at issue. This article examines, more specifically, issues involving security interests in personal property.

- <u>First In Time, First In Line</u>

Under the UCC, secured parties' rights are often determined by the rule "first in time, first in line." This simply means that the first person to perfect his security interest in property is the first person who gets paid from the sale of that property. Moreover, this is generally true regardless of when the secured party entered into its respective contract with a debtor. For example, if Secured Party A's lease was signed on January 1, 2017, and the security interest given in the lease was perfected on April 1, 2017, and Secured Party B's GIA was signed on February 1, 2017, and the security interest given in the GIA was perfected on March 1, 2017, then Secured Party B would get first "dibs", or priority, in the debtor's personal property.

Getting first "dibs" in the personal property is important for several reasons. First, under state law, if you decide to enforce your rights in, for example, the debtor's construction equipment, the secured party with the "priority" in the construction equipment gets paid first. If you hold the second "priority" interest in the construction equipment and it does not sell for more than the first "priority" interest's amount, you get paid nothing, and the security interest gives you no benefit.

Second, in the context of bankruptcy proceedings, having the first "dibs" or priority in the debtor's personal property, in particular cash, gives you extra protection. For example, if you hold the first priority interest in the debtor's cash, then your consent will be necessary for the debtor to use the cash to operate its business in the bankruptcy. Moreover, you could demand additional protection for use of the cash in the form of monthly payments or new collateral in property not otherwise subject to your secured interest.

- <u>Perfecting The Security Interest</u>

So, what does it take to "perfect" a security interest? The answer varies depending on the property at issue and the state in which the property sits. Most security interests in personal property are perfected by filing a

UCC-1 financing statement with the appropriate agency in the state where the property is located. Other forms of perfection include having control over the property or taking possession of the property.

The UCC-1 financing statement is a short form that requires the secured party to describe the property covered by the security interest. The level of specificity required in the description will depend in part on the applicable state law and in part on the contract giving rise to the security interest. For example, secured parties often describe the property covered by a security interest as "all assets or all personal property" of the debtor.

- Once I File A UCC-1 Financing Statement, I Can Sit Back And Relax, Right? Maybe, It Depends On What Happens Next.

  - *The UCC-1 Financing Statement Was Filed More Than 5 Years Ago*

Generally, a UCC-1 financing statement is only effective for 5 years from the date of filing. You can extend your UCC-1 financing statement by filing a UCC-3 continuation statement in the 6 months before the 5 year expiration date. If you fail to extend your UCC-1 financing statement before the expiration of the 5 years, you may find that you have lost your perfected status. As a consequence, you may find that your "priority" in the secured property is lost, which means the party second in line may rise to first "dibs" in the collateral. Whether the party second in line gets first "dibs" after a UCC-1 financing statement expires depends on the nature of that party's security, *i.e.*, a judgment creditor versus a creditor.

  - *The Debtor Moved To A New State.*

Despite the slight variations in the UCC provisions adopted by each state, if the debtor moves to a new state, to maintain a perfected security interest in the debtor's personal property, you will have to file a UCC-1 financing statement in the new debtor's state of residence. Most states give the secured party a few months to get a new UCC-1 financing statement filed.

  - *The Debtor Changed Its Name.*

If the debtor changes his or her name such that the UCC-1 financing statement becomes seriously misleading, *i.e.*, it is unclear who or what the UCC-1 financing statement covers, then you will likely have to file an amendment to update the name of the debtor. Most states provide the secured party a few months to file an amendment to the UCC-1 financing statement.

  - *Filing A Termination Statement When There Is No More Debt*

When and whether a secured party is required to file a termination statement depends on the type of property covered by the UCC-1 financing statement, *e.g.*, consumer goods or non-consumer goods. Once the obligation covered by the security interest is satisfied or terminates, however, the secured party should be prepared to file a termination statement.

Conclusion

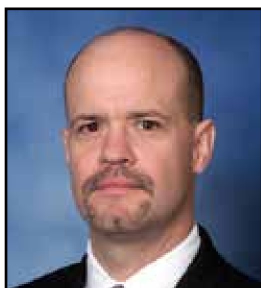
Don't wait until the indemnitor, tenant, or debtor defaults under your contract. Plan in advance for the worst to protect yourself and get the best mileage out of that security interest clause you negotiated for in your contract.

Watt Tieder newsletters are posted on our website, www.watttieder.com, under the Resources Tab. If you would like to receive an electronic copy of our newsletter, please contact Peggy Groscup at: **pgroscup@watttieder.com**

BUILDING SOLUTIONS

Reflections From the Republic Of Korea: Opportunities Abound For Korean Contractors

by Edward J. Parrott, Senior Partner, Mark Rosencrantz, Partner and Christine J. Lee, Associate


Edward J. Parrott

Mark Rosencrantz

Christine J. Lee

Introduction

Over the past several years Watt Tieder's presence in Asia as a top-tier international construction law firm has continued to grow, especially in the Republic of Korea. During the week of June 19, 2017 Watt Tieder gave a series of lectures hosted by top Korean law firm Kim & Chang and the International Korean Contractors Association in Seoul. The lectures focused on the United States' procurement systems, trends and potential opportunities for Korean contractors on public and private projects, and international arbitrations under the International Chamber of Commerce ("ICC") and similar systems. While there, Watt Tieder continued its series of meetings with nearly a dozen of the largest Korean conglomerates to discuss their current plans and needs.

Questions during the lecture series and in private meetings underscored the Korean construction community's substantial interest in the potential for President Trump's proposed $1 trillion infrastructure package, Public Private Partnership ("PPP") opportunities, as well as a need for controlling costs in the conduct of international arbitrations. Other areas of significant interest included existing levels of construction spending in the United States, which are expected to exceed $1 trillion in 2017, as well as common legal issues and barriers faced by foreign contractors, and how they can be addressed.

The Current U.S. Public Construction Market

As has been extensively discussed in news reports, the United States federal government, as well as state governments, need to invest significant sums in infrastructure in the coming years. As CNBC.com recently reported:

> Nearly every state is currently struggling just to keep its existing infrastructure in good repair, let alone finding enough money to address rapidly growing new demands on transportation and other systems. Each year that another critical repair or capacity expansion project is deferred, it costs us dearly. Although the current debate has focused on $1 trillion over ten years, experts contend that we need to spend even more and much quicker.

The overall gap between the U.S.'s infrastructure needs and current funding is often pegged at around $2 trillion. The American Society of Civil Engineers (ASCE) estimates that investment gap will result in dramatic costs to the U.S. economy by 2025: $3.9 trillion in losses to gross domestic product; $7 trillion in lost business sales; and the loss of 2.5 million American jobs.

Given this reality, it is no surprise that the opportunity to bid on public construction projects was a significant topic of conversation during our private meetings as well as during the seminars. In particular, Korean contractors are keenly interested in President Trump's proposed $1 trillion infrastructure package, and the opportunities it might present.

As discussed during the trip, however, no federal infrastructure package has been approved or

even introduced in Congress. As the New York Times recently explained:

> Infrastructure remains stuck near the rear of the legislative line, according to two dozen administration officials, legislators and labor leaders involved in coming up with a concrete proposal. It awaits the resolution of tough negotiations over the budget, the debt ceiling, a tax overhaul, a new push to toughen immigration laws — and the enervating slog to enact a replacement for the Affordable Care Act.

Mr. Trump's team has yet to produce the detailed plan he has promised to deliver "very soon," and the president has yet to even name any members to a new board he claimed would green-light big projects.

Despite the delays, we believe it likely that an infrastructure package will be passed in the not too distant future. Aside from the fact that bridges and other critical infrastructure projects are becoming unsafe and unusable, the job creation and resulting economic benefits of such projects is something members of both political parties are likely to agree on.

Even without the passage of a new infrastructure bill, however, many opportunities exist for Korean contractors who are interested in the American market. The United States federal government already spends approximately $400 billion annually on construction, which provides tremendous opportunities for Korean contractors. Similarly, state and local governments also spend billions of dollars. Upcoming opportunities include, among others, light rail and subway projects, bridges, airport renovations, large buildings, and sports stadiums.

Contractors who are interested on bidding on federal construction projects are well advised to regularly consult http://cbd-net.com, which lists all procurement opportunities with the U.S. Government, as well as subcontracting leads and foreign business opportunities.

The Private Construction Market Also Has Many Opportunities for Korean Contractors

Construction spending in the United States is at its highest level since 2006. A significant portion of that is private construction projects that many Korean contractors are well qualified to build. As of last month, Seattle, Washington alone had 58 construction cranes dotting its skyline, with Portland, Oregon and San Francisco and Los Angeles, California adding 90 more. Chicago, Illinois, Washington, D.C. and many other cities in the United States and Canada also have extensive opportunities for large, sophisticated contractors.

For example, Seattle and San Francisco continue to build office and high-rise residential buildings at record paces. Similarly, plans are underway in several US cities to construct significant new professional sports stadiums (Las Vegas, Nevada; Oakland, California; and Los Angeles, California) and Seattle, Washington is seriously studying the feasibility of significantly renovating one of its stadiums.

Korean contractors interested in learning about opportunities for private construction projects should regularly check http://DodgeProjects.Construction.com, which publishes upcoming private construction projects.

Use Of PPP Projects In The United States And Canada Is On The Rise

Regardless of whether President Trump is able to get his proposed $1 trillion infrastructure package passed, it seems certain that the use of PPPs in the United States will increase due to the sheer magnitude of infrastructure work that needs to be done. It should thus come as no surprise that www.infrapppworld.com lists 92 PPP projects in the United States and Canada that are currently in tender, with more being planned.

Use of PPP projects has proven successful in other parts of the world, and after a somewhat slow start in the United States, they seem poised to be used in ever increasing numbers as infrastructure needs dictate that projects be built. As the use of PPPs expand in the United States, contractors who are able to demonstrate success in early projects, as well as those who already have experience in other countries, will be uniquely qualified to bid on and obtain future projects.

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Watt Tieder Is Well Positioned To Assist Korean Contractors Enter The U.S. Market

For a variety of reasons, the United States can be a daunting market for foreign contractors to enter. Licensing requirements vary greatly from state to state. Joint venture relationships should always be formalized with written contracts. And bidding on public projects is difficult, with proposals needing to comply with numerous specific requirements. The penalty for not providing exactly the information requested can often be having a bid rejected that might otherwise be successful. With our decades of experience, Watt Tieder is well positioned to assist Korean contractors to successfully enter the U.S. market with licensing help, setting up U.S. subsidiaries, preparing joint venture agreements, reviewing bids, assisting companies in finding office space and negotiating leases, and a multitude of other issues.

Watt Tieder Is Planning An Upcoming Seminar On The Efficient Conduct Of International Arbitration

In response to concerns expressed by many of the Korean contractors during our recent trip, Watt Tieder is planning a seminar on the efficient conduct of international arbitration. During the seminar we will review our basic approach to the expeditious conduct of complex international construction disputes. Among the presenters will be Watt Tieder founding partner Jack Tieder, who is the author of the 2017 Construction Law Update chapter entitled *International Arbitration Under The 2012 ICC Arbitration Rules, As Amended Effective 1 March 2017*. Jack has also served as both a panel member and lead counsel on nearly 50 complex international arbitrations under the ICC and UNCITRAL, among many other international arbitration boards. Anyone interested in attending the seminar or receiving materials should contact any of the authors of this article for additional information. We will also announce the seminar in upcoming editions of this Newsletter.

Conclusion

The United States is poised to spend trillions of dollars on construction in the coming years. With their experience in constructing major projects all over the world, Korean contractors are poised to capture major projects in nearly every sector.

FIRM NEWS

Honors

Super Lawyers

Watt Tieder is pleased to announce that its attorneys have once again been recognized by **Super Lawyers 2017**. **Super Lawyers** is an annual listing of lawyers who have achieved a high level of peer recognition and professional merit. Over sixty practice areas are evaluated during the selection process. Super Lawyers Magazine, published by Law and Politics, a division of Key Professional Media, Inc., is distributed nationwide.

The following Watt Tieder attorneys were named as 2017 Super Lawyers:

- McLean, Virginia – **John B. Tieder, Jr., Robert M. Fitzgerald, Lewis J. Baker, Vivian Katsantonis; Jennifer L. Kneeland**
- Irvine, California – **Robert C. Niesley**
- Chicago, Illinois – **John Sebastian**
- Las Vegas, Nevada – **Jared Sechrist**
- Miami, Florida - **Rising Star Mariela Malfeld**

Recent and Upcoming Events

International Korean Contractors Association/ Kim & Chang, June 19, 2017; Seoul, Korea; **Edward J. Parrot**, **Mark Rosencrantz** and **Christine J. Lee** presented on an "Introduction to Construction Law and Contracting in the United States." They also presented on June

20, 2017 on "Construction Law and Contracting in the United States: Advanced Topics."

Midwest Surety & Construction Claims Conference 2017, July 20, 2017; Chicago, IL; **Watt Tieder** co-sponsored and **John E. Sebastian**, **Lauren E. Rankins**, **Erica Del Aguila** and **Aniuska Rovaina** presented on Payment Bond Defenses. John Sebastian also moderated a panel on "Effective Communications with Bond Claimants."

Pearlman Association's Annual Conference 2017, September 7-8, 2017; Seattle, WA; **Thomas K. Windus** will appear on a panel discussing "Defenses to Warranty Claims."

28th Annual Northeast Surety and Fidelity Claims Conference, September 13-15, 2017; Atlantic City, N.J.; **Christopher M. Harris** and **Adam M. Tuckman** to speak on a panel with industry experts on a "Surety's Unique Risks When Bonding Contracts Utilizing Alternative Delivery Methods."

28th Annual Northeast Surety and Fidelity Claims Conference, September 13-15, 2017; Atlantic City, N.J.; **Christopher J. Brasco** and **Vivian Katsantonis** to speak on a panel with industry experts on "Effectively Handling a Surety's Government Contract Claims at the Court or Board."

Construction Financial Management Association ("CFMA") Midwest Regional Conference, September 27, 2017; Chicago, IL; **Christopher J. Brasco** and **John E. Sebastian** to participate in a panel discussion entitled **"Construction Documentation: Successfully Managing Risk and Preserving Claims."**

University of Stuttgart, September 28-30, 2017; Stuttgart, Germany; **John B. Tieder, Jr.** to speak on international construction law.

CMAA National Convention, October 8-10, 2017; Washington, D.C.; **Christopher J. Brasco** and **Kathleen O. Barnes** to speak in a panel session entitled "Swords or Plowshares? Using Technology and Tools to Build Projects, Not Lawsuits."

International Bar Association, Annual Conference 2017, October 8-13, 2017; Sydney, Australia; **Shelly L. Ewald** to speak on October 12 on "Projects Under Pressure: Is There Any Escape?" with consideration of suspension, termination and renegotiation possibilities and consequences, as well as mock negotiations.

International Construction Law Association, Contracting for China's "One Belt One Road" Project, October 21-22, 2017; Peking University Law School, Beijing, China; **John B. Tieder, Jr.** to speak.

Risk Management in Underground Construction Conference, November 28-29, 2017; Washington, D.C.; **Kathleen O. Barnes** will be participating in a session on case histories and lessons learned.

Construction SuperConference, December 5-6, 2017; Las Vegas, NV; **Shelly L. Ewald** to speak on admission of expert witness testimony. **Christopher J. Brasco** and **Vivian Katsantonis** will be participating in a panel session entitled "Strategies for Prompt and Effective Resolution of Government Claims Utilizing the Court of Federal Claims and Board of Contract Appeals." **Kathleen O. Barnes** and **David F. McPherson** will also be participating in a panel discussion entitled "Complex or Bet the Company Case? Win the War Through Strategic Decisions on Forum Selection, Innovative ADR, ESI Management, Budgeting and More."

Publications

John B. Tieder, Jr. wrote a chapter in the **2017 Construction Law Update**, published by Wolters Kluwer, entitled "International Arbitration Under the 2012 ICC Arbitration Rules as amended, effective 1 March 2017."

Rebecca Glos, **Amanda L. Marutzky** and **Mariela M. Malfeld** published an article in the Florida Insurance and Surety Committee Newsletter, "Subcontractor Default Insurance and Suretyship: A Primer on the Distinction Between the Two" (May 2017).

Announcement

Watt Tieder is proud to announce that **Mariela M. Malfeld** is board certified in Florida construction law.

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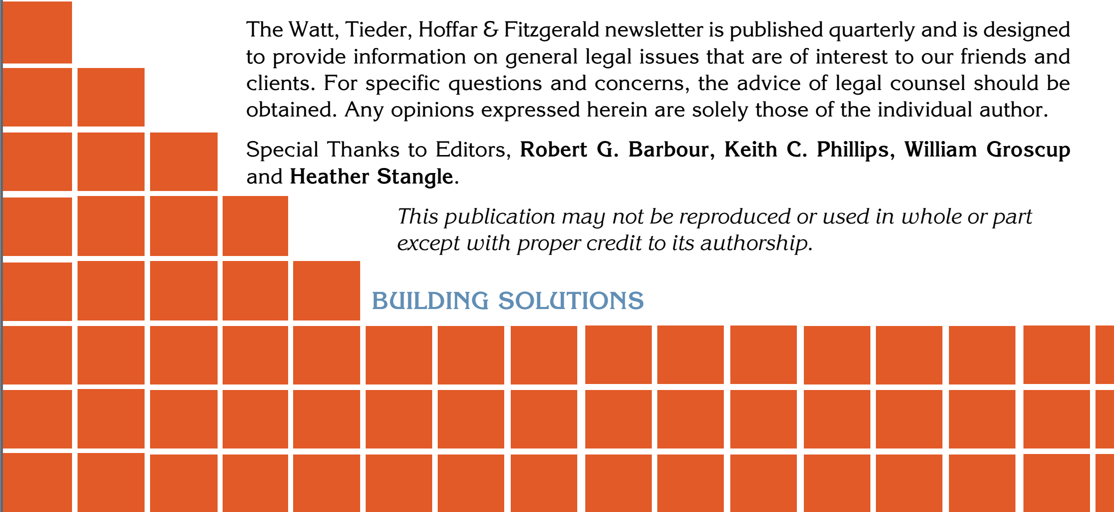

The Watt, Tieder, Hoffar & Fitzgerald newsletter is published quarterly and is designed to provide information on general legal issues that are of interest to our friends and clients. For specific questions and concerns, the advice of legal counsel should be obtained. Any opinions expressed herein are solely those of the individual author.

Special Thanks to Editors, **Robert G. Barbour, Keith C. Phillips, William Groscup** and **Heather Stangle**.

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