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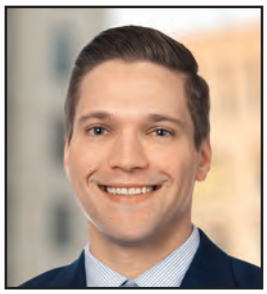

The Consequences Of Consequential Damages In Construction Contracts

by Brian C. Padove, Partner

Whether it is an owner, contractor, or subcontractor, when construction entities enter into contracts their general focus is typically on a few interrelated goals: completing the project on time, within budget, and making a profit. An often-overlooked aspect of contracting, however, relates to potential liability in the event of a breach, more specifically, consequential damages. While it is relatively easy to foresee direct damages resulting from a breach of contract, it is more difficult to foresee, understand, and protect oneself against damages that may not be directly caused by a breach, but nevertheless, result from that breach – more specifically, consequential damages.

This article will provide an overview of consequential damages in the construction industry and why such damages should not be overlooked when contracting, followed by a summary of how parties may choose to confront such damages when contracting. The article will then conclude with a practical summation of tips to consider relating to consequential damages.

Consequential Damages

Consequential damages, also known as indirect or special damages, are damages that are not directly caused by a breach of contract, but are, nonetheless, a result of a breach. In essence, these types of damages provide a mechanism for compensating non-breaching parties for losses that are not directly caused by a breach, but still result from said breach. These damages can be significant in construction contracts, as they can include costs related to delays, lost profits, and other financial losses. For example, if a contractor fails to complete a project on time, the owner may suffer consequential damages such as lost profits or increased financing costs. On the other hand, for a contractor, a breach may result in indirect costs such as lost profits due to increased costs from the breach. In short, the definition of consequential damages generally takes an "all-encompassing" view of damages and includes all such damages that may arise out of a breach, including damages that are only indirectly caused by the breach. Because of this, the breadth of liability potentially available as "consequential" damages is substantially more than damages that are solely directly caused by a breach. Therefore, it is important for construction entities to understand the concept of consequential damages in construction agreements.

One of the most prominent reasons the concept of consequential damages is important is that such damages may have a significant impact on: (1) the profitability of a project; (2) the construction entity that suffers from those damages; and (3) the construction entity that may be liable for those damages. Below are just some brief examples of consequential damages in the construction context:

Lost Profits: These damages are one of the most prevalent in the construction industry. They relate to profits that would have been earned if the project had been completed on time and according to the contract terms. For example, from the owner's perspective, if there is a delay to a commercial property which prevents a business from opening on time, the owner may be able to claim lost profits as a result of the delay. On the other hand, from the contractor's perspective, if there is an owner-caused delay which causes increased costs cutting into the contractor's estimated profit on the project, the contractor may be able to claim lost profits.

Increased Operations Costs: These damages relate to the additional costs a party may bear as a result of a project delay or breach of contract. While relatively straightforward, they generally refer to additional operation costs, such as increased costs for a contractor to obtain materials.

Loss of Business Opportunities: This type of damage relates to opportunities that are lost as a result of a project delay or breach of contract. For example, if a delay in a commercial construction project causes an owner to miss

a key business opportunity, such as a major event, the owner may be able to claim a loss of business opportunities. Likewise, if the breach causes the contractor to be unable to bid on and win some other project/work, the contractor may be able to recover under a claimed loss of business opportunity.

While the above is not an exhaustive list, the different types of consequential damages arising out of a breach of contract is, in essence, infinite. These damages can even include intangible losses that may occur, such as damage to a company's reputation. Thus, because there are numerous ways in which a non-breaching party may claim that a loss is a "consequential damage" of a breach as well as the boundless potential liability for such damages, it follows that consequential damages can have a major impact on not only a construction project, but also on the viability of construction entities.

Contract Provisions

Because there is a potential for significant loss as a result of consequential damages, it is not surprising that parties often seek to limit their exposure to these damages through the use of waiver of consequential damages clauses or clauses limiting exposure only to certain types of consequential damages. One way in which parties do this is through liquidated damages clauses. While this article will not dive into such clauses, the general idea is that parties will include a liquidated damages clause which sets a fixed amount of damages that will be owed for a specific type of damage. For example, the clause might provide that if a contractor breaches the contract, it will owe a specified amount of liquidated damages for each day the project is delayed beyond the completion date. Such damages represent the owner's estimated damages for increased costs of financing or other indirect costs. In essence, these clauses (as well as other clauses which specifically set out consequential damages allowed and/or waived) essentially relieve one party (or both parties) from liability for indirect damages that may be incurred as a result of a breach of contract or limit such liability. The effectiveness of these clauses, however, can vary depending on the specific language used and the jurisdiction in which the contract is being enforced. Some jurisdictions may not allow for the waiver of consequential damages in certain circumstances, such as when the damages were foreseeable at the time the contract was entered into. In other cases, a court may find that a waiver of consequential damages clause is overly broad and therefore partially unenforceable. In other words, it may be difficult to determine what damages are actually "consequential" and thereby applicable to a waiver, compared to which damages are direct damages and therefore not subject to the waiver. *See, e.g., Chinese Hospital Association v. Jacobs Engineering Group, Inc.*, No. 18-cv-05403-JSC, 2019 WL 6050758 (N.D. Cal. Nov. 15, 2019).

Nevertheless, despite the potential limitations on enforceability of wavier of consequential damages clauses, they can be a useful tool for parties. Specifically, these clauses can help limit the potential exposure to indirect damages and can provide greater clarity and certainty around the potential costs and risks associated with a project. Without a consequential damages clause setting forth what damages are recoverable and/or what damages are expressly waived, it can be difficult to accurately assess the damages suffered by a party in the event of a breach leading to more uncertainty and adding fuel to the already brewing dispute between parties. In addition, the inclusion of such clauses may serve as a deterrent to parties who may be tempted to breach their contract. For example, if a party is aware that it may be held liable for significant consequential damages in the event of a breach (e.g., lost profits) or liquidated damages, that party may be inclined to do everything possible to adhere to the terms of the contract and avoid breaching the contract. All said, including waiver language relating to certain consequential damages provides limits on potential significant liability relating to damages that may arise out of a breach (but which may not be direct damages of a breach).

With this in mind, one example of a mutual waiver of consequential damages can be found in ConsensusDocs200 at Section 6.6. In relevant part, Section 6.6 provides for a waiver of consequential damages (other than those damages that are determined to be liquidated damages as set forth in other portions of the Agreement). Specifically, in Section 6.6, the Owner waives damages including rental expenses incurred, loss of income, loss of profit, loss of business, loss of financing, and loss of reputation. The contractor waives certain losses including loss of business, loss of financing, loss of profits, loss of bonding capacity, loss of reputation, and insolvency. While this limits the amount of damages the non-breaching party may recover, this type of provision provides some relative certainty as to the amount of damages that may arise as a result of a breach of contract for all parties.

Practical Considerations

Overall, in the event of a breach of contract, consequential damages can have a substantial

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impact on the total extent of liability relating to a breach. Without any "checks" on these damages, the potential damages for things such as lost profits as a result of delays can be massive. Given this uncertainty, parties often times negotiate waivers/limitations on such consequential damages. While the waivers limit potential recovery for a non-breaching party, the waivers provide a more defined scope of damages that may be at issue should a breach occur and a dispute arise. That said, below are some practical considerations relating to consequential damages in the construction industry:

1. Definition of Consequential Damages: Clearly define the scope and meaning of "consequential damages" in the contract in specific and unambiguous language to avoid disputes later on.

2. Foreseeability of Damages: Consider the foreseeability of the damages at the time the contract is formed. Damages that are direct and foreseeable should not be considered consequential damages.

3. Allocation of Risk: Allocate the risk of consequential damages between the parties in a fair and equitable manner. For example, a contractor may agree to bear the risk of certain types of damages while the owner may agree to bear the risk of others.

4. Limitation of Liability: Consider limiting the liability of each party for consequential damages in a way that is reasonable and proportional to the parties' relative needs. For example, utilizing ConsensusDocs200 and its Section 6.6 may address these concerns.

5. Notice Requirements: Consider including notice requirements in the contract to ensure that the parties are aware of any and all potential consequential damages and to provide an opportunity to resolve any disputes prior to escalation.

By carefully considering the above, construction entities can ensure they have a comprehensive understanding of the potential "consequences" of "consequential damages," and that they are taking steps to protect themselves from the substantial impact such damages may have on a construction dispute.

RECENT DEVELOPMENTS

Electronic Signatures On Contracts: Are They Truly Compliant?

by Rebecca S. Glos, Partner

As companies move to work-from-home situations in the wake of the COVID-19 pandemic, the issue of whether electronic signatures are legally recognized becomes more relevant. For many platforms, an electronic signature merely requires logging in, clicking a button, or typing your name. This process, which replaces the mighty pen and quill, is so effortless that oftentimes an electronic signature may feel like it does not carry the same weight as a handwritten signature. Thus, the question that we should be asking ourselves is whether the law recognizes this type of signature as being valid? Additionally, if electronic signatures are, indeed, valid, are there exceptions on whether they can be used?

Difference Between "Electronic" And "Digital" Signatures

Before delving into this issue, an understanding of some related terms may be helpful. In basic terms, an ***electronic signature*** (or "e-signature") is any signature created or captured through a computer or other electronic device. Electronic signatures can include touch-sensitive screens where you use your finger or a stylus to sign your name as you would on a paper document. Electronic signatures can also include forms where you merely type in your name and perhaps other identifying information, then check a box stating that you intend to sign the document. They cover the full range of technologies and solutions to create signatures electronically such as:

- Clicking "I Agree" on a website;
- Signing with your finger on a mobile device;
- Typing your name or PIN into an online form; or
- Using e-signature software

A ***digital signature***, on the other hand, is a subtype of electronic signatures that uses encryption called public key infrastructure (PKI) to associate a signer with a document and to protect the signed document. Once a document is digitally signed, it is locked and no additional signatures, annotations, or form fill-ins are allowed. If the document is changed at any time after signing, the signature is considered invalid. Certain states, such as California, have enacted regulations adopted by the Secretary of State which define the types of technologies that are acceptable for creating digital signatures for use by public entities.

To summarize, an e-signature is a generic term for any signature transmitted electronically (whether it is a digitally written signature or a signature generated through an electronic document signing service), whereas a digital signature has more advanced features that keep the signature secure.

Enacted Legislation Regarding Use Of Electronic Signatures: ESIGN And UETA

In 2000, the U.S. federal government passed the Electronic Signatures in Global and National Commerce Act ("ESIGN") (15 U.S.C. Section 7001 *et seq.*) which grants legal recognition to electronic signatures and records in the United States if all parties to a contract choose to use electronic documents and to sign them. This piece of legislation made electronic signatures legal in every U.S. state and territory where federal law applies. It places electronic signatures on the same level as handwritten signatures in terms of legality. Generally, the following components must be present for electronic signatures to be fully protected and upheld under ESIGN:

- Evidence of a clear intent to sign the document;
- Expressed consent to conduct business electronically;
- An option to opt out of doing business electronically; and
- Distribution and retention of the digital documents.

In some states and territories, the precursor to ESIGN, the Uniform Electronic Transactions Act ("UETA"), is in effect. UETA is one of the several United States Uniform Acts proposed by the National Conference of Commissioners on Uniform State Laws and holds that electronic signatures are legally binding if certain requirements are met. As with ESIGN, under UETA, an electronic signature may be used when a signature is required by law with certain exceptions. The documents exempt from UETA include wedding certificates, birth and death certificates, wills, and other estate documents. Of the 49 states in the U.S., only New York (along with the District of Columbia, Puerto Rico, and the Virgin Islands) has not adopted UETA.

The primary difference between ESIGN and UETA is the level at which they were enacted. ESIGN is a federal digital act whereas UETA is a state level act which 49 out of the 50 states have adopted. Where federal law does not apply, ESIGN cannot be enforced. At the state or territory level, UETA can be used for electronic signature protections.

Some states, such as California, have enacted their own regulations governing the use of digital signatures in addition to what is required under ESIGN and UETA. For instance, under California Government Code section 16.5, a digital signature shall have the same force and effect as a manual signature if and only if:

- It is unique to the person using it;
- It is capable of verification;
- It is under the sole control of the person using it;
- It is linked to data in such a manner that, if the data is changed, the digital signature is invalidated; and
- It conforms to regulations adopted by the Secretary of State.

Exemptions Under ESIGN and/or UETA

ESIGN and UETA do not apply to all transactions. The parties must have "agreed to conduct the transaction electronically" in order for the acts to apply. Additionally, even with such an agreement, certain types of transactions and associated documents are excluded from ESIGN and UETA (as adopted by the applicable state). In particular, the protections afforded by ESIGN do not apply to:

- Wills, codicils, or testamentary trusts;
- A State statute, regulation, or other rule of law governing adoption, divorce, or other matters of family law;
- The Uniform Commercial Code, as in effect in any State, subject to certain limited exceptions;
- Court orders or official court documents;

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- Notices of cancellation of utility services;
- Notices of default, foreclosure, or eviction of an individual from their primary residence;
- Termination notice for health or life insurance policies;
- Recall notices for products that pose a considerable risk to health or safety; and/or
- Any document legally required to transport hazardous materials, pesticides, or other toxic substances.

Further, UETA does not apply to transactions governed by the Uniform Commercial Code ("UCC") other than Articles 2 and 2A (Sales & Lease Agreements). The UCC, however, has its *own* provisions for electronic authentication. Starting with UCC Article 3 (Negotiable Instruments), nothing in the UETA prohibits the use of an electronic signature on a promissory note. Because paper promissory notes are "negotiable instruments" under the UCC, however, having "possession" of the "original" signed note is legally significant. Therefore, UETA sets forth special rules as it relates to electronic promissory notes – they must be considered a "transferable record" in order to be considered a negotiable instrument. If the promissory note is a "transferable record," the person identified as in "control" of the record becomes the equivalent of a "holder" under the UCC. In order to be considered a "transferable record," however, the promissory note must meet certain criteria, which in part requires "a single authoritative copy of the transferable record" and that each copy of the authoritative copy and any copy of a copy be readily identifiable as a copy. In short, electronic signatures cannot be used for instruments of title unless an electronic version of such record is created, stored, or transferred in a manner that allows for the existence of only one unique, identifiable, and unalterable version that cannot be copied except in a form that is readily identifiable as a copy.

Use Of Electronic Signatures On A Power Of Attorney

A power of attorney ("POA") allows one party, the agent, to make financial decisions on behalf of another party. Under a POA, such authority can be extended to making decisions regarding the grantor's medical care, personal property, and/or finances. Given the amount of discretion that is being afforded thereunder, a POA usually must be signed in front of a notary public to be considered legally binding. In today's climate where remote business transactions are the norm rather than the exception, a common question raised is whether a POA can be signed with an electronic signature? The answer is not straightforward but instead depends on the nuances of ESIGN, UETA, and state laws governing the use of electronic signatures.

Under ESIGN and UETA, electronic signatures (instead of a traditional wet signature) are only authorized during a "transaction" related to "business, commercial, or governmental affairs." Therefore, the appointment of an agent under a POA for certain purposes may not fall within these categories. For instance, a healthcare directive may not be considered "conduct[ing]...business, commercial, or governmental affairs." Moreover, many states have specific requirements for POAs related to healthcare such as how they can be executed, acknowledged, and even notarized. If the appointment of such an agent does not fall within the statutory definition of "transaction," neither ESIGN nor UETA would apply and, therefore, electronic signatures may not be permitted. In short, the ability to use electronic signatures in connection with a POA largely depends on the purpose for which the POA is created, as well as any specific legal requirements related to the formation of the POA. One must determine what state law governs the POA and whether that type of POA can be signed electronically under the laws of that jurisdiction.

If a POA for a particular use falls within the definition of "transaction" related to "business, commercial, or governmental affairs" (and, thus, an electronic signature is permitted), there is still the question of whether the document must be notarized. While some states, such as Maine (Me. Rev. Ann. Tit. 18-A, § 5-905 (2012) (deviating from the Uniform Power of Attorney Act by requiring power of attorney to be acknowledged to be valid) and West Virginia (W. Va. Code Ann. § 39B-1-105 (LexisNexis Supp. 2013)) require mere acknowledgement, other states, such as Maryland (Md. Code Ann., Est. & Trusts § 17-110 (LexisNexis 2011 & Supp. 2012)), require a POA be witnessed and notarized. For states that require notarization, the next question which arises is whether the notarization can be done electronically.

Traditional notarization requires that the signer be physically present before a notary so that the signature can be authenticated, while electronic notarization permits the notary's signature and stamp to be added to a document through electronic means. States that permit e-notarization include Arizona, Arkansas, California, Colorado, Delaware, Florida, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Montana, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode

Island, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, and Wisconsin. Some states, such as Virginia, Montana, Texas, and Nevada, will even allow digital notaries to remotely notarize documents from a webcam. Once again, then, the answer to the question of whether notarization can be performed electronically depends on the laws of the state in which the notarization is to be performed.

Conclusion

The above describes key considerations regarding the use of electronic signatures in transactions. Determining whether and how to use electronic signatures in a particular transaction, however, must be tailored to the parties' specific needs and the facts of such transaction. Further, while electronic signatures are widely accepted for many business transactions in the U.S. and internationally, there are some circumstances in which a wet signature is still required. Understanding the governing laws within the state in which the document is to be signed (and whether the state has adopted ESIGN and/or UETA) is both prudent and necessary before deciding whether to use an electronic signature.

CALIFORNIA UPDATE

Drone Use On California Construction Projects

by Brent N. Mackay, Partner

The use of drones, or small unmanned aircraft systems ("UAS"), has become common throughout the construction industry in all phases of construction, including pre-construction, progress of the work, project closeout, and maintenance. This article looks at five (5) areas to evaluate in connection with using drones on California construction projects: (1) federal regulations; (2) state laws; (3) local laws; (4) project location; and (5) weather conditions.

Federal Regulations

Regardless of the state in which the project is located, companies and persons operating commercial drones must observe regulations promulgated by the Federal Aviation Administration ("FAA"), which has the exclusive authority to regulate aviation safety, airspace navigation, and air traffic control.

In June of 2016, the FAA released 14 C.F.R. Part 107 of the Federal Aviation Regulations ("Part 107"), which regulates the use of drones when operated for commercial purposes. Small drones or UASs are defined as weighing less than 55 pounds on takeoff. Some of the initial FAA regulations involved operational parameters or restrictions including: (a) the drone pilot must be within sight of the drone during operation; (b) the drones could not be flown over any person who was not directly participating in the operation of the drone; and (c) drone operations could only be conducted in daylight or civil twilight (30 minutes before sunrise to 30 minutes after official sunset). Although waivers could be obtained from certain Part 107 requirements provided the pilot demonstrated the drone could be operated without endangering life or property, the process could be lengthy and cumbersome to address the many operational restrictions.

In April of 2021, the FAA amended Part 107 at least in part to streamline the regulations relating to commercial drone use, including the requirements relating to flying at night and over people. These most recent Part 107 amendments expand use opportunities over construction sites and potentially lower compliance costs for drone usage on construction projects.

- **Flying Drones At Night**

Previously, commercial operators had to obtain a waiver to fly their drones at night, which required a significant amount of risk mitigation. Now, however, amended Part 107 permits night flight without the time and expense of a waiver

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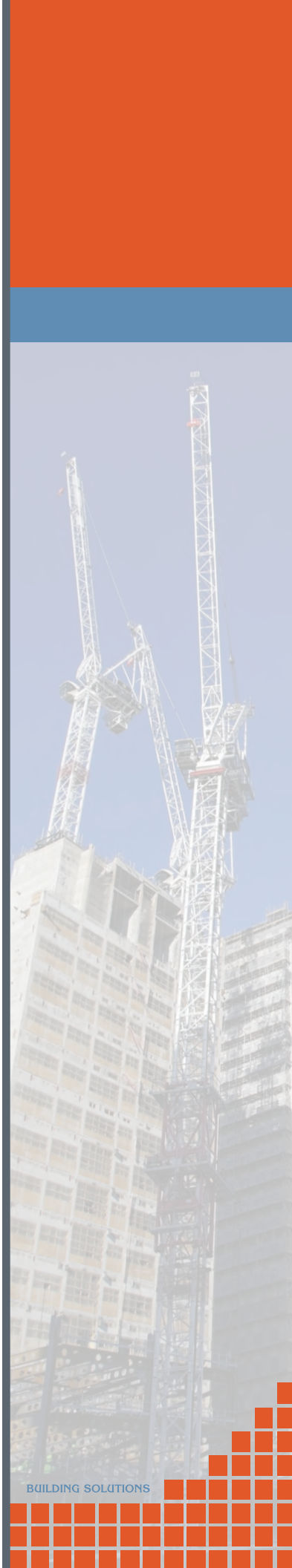

and risk mitigation, provided companies utilize a drone pilot with current night certification and the drone has certain anti-collision lighting. The pilot must obtain and maintain night flight certification every two years. *See* §§ 107.29, 107.73.

- **Flying Drones Over People**

When Part 107 was initially issued, commercial drones were not permitted to be flown over people unless a waiver was obtained. Under recent amendments, commercial entities no longer need to apply for a project-specific waiver. Instead, commercial operators are now able to fly over people without having to incur the time and expense of a waiver based on the restrictions placed on the category of the selected FAA-approved drone model. §§ 107.100, *et seq*.

The drones (or UASs in FAA terminology) are now classified into 4 different categories, with each category having different requirements or thresholds relating to weight and amount of kinetic energy produced upon impact from a rigid object, or exposed rotating parts (e.g., propellers). In other words, if the drone or something connected to the drone comes into contact with a human being, what is the potential risk and extent of personal injury or death? Category 1 contemplates the smaller or micro-drones, and each of the remaining categories relates to correspondingly larger and heavier drones. *See* §§ 107.110-107.140.

Because drone manufacturers will conduct the testing to obtain approval from the FAA as to how the model can be categorized, compliance costs of flying over human beings will now be largely borne by the drone manufacturers instead of commercial entities, such as construction companies.

California State Laws

Although commercial drone operations in California are approved under Part 107 of the FAA, additional laws exist at the state level which should be evaluated. California, like many other states, has passed various laws directly relating to drone usage. Most of them arise in the context of first responders and emergency situations and do not appear to have general application to construction projects. For instance, Section 43.101 of the Civil Code provides first responders immunity in the event they damage a drone that was interfering during the course of the responder administering emergency services. Similarly, under Penal Code section 402, it is a misdemeanor to interfere by drone with activities of first responders during an emergency. Such laws appear to have very little application to construction projects.

In contrast, Civil Code section 1708.8, sometimes characterized as an "anti-paparazzi" law, may be applicable to certain construction projects as it creates a civil cause of action against anyone knowingly entering into the airspace of another in order to capture an image or recording of that person engaging in a private, personal, or familial activity without permission. This statute has "teeth" as it provides the successful litigant with the potential of obtaining, among other things, treble and punitive damages. As such, construction professionals should take care to understand and plan for potential privacy issues depending on such factors as project location, as well as the background of the commercial drone operators being utilized.

Additionally, although not drone-specific, California statutes codifying a general duty of care (Civil Code § 1714(a)) and private nuisance (Civil Code §§ 3481, 3501) could potentially apply under certain circumstances. This may include, among other things, situations where personal injury results from contact with a drone.

Local Laws

As demonstrated by selected examples below, local (e.g., county and city) restrictions vary and interested parties should take steps to ensure they are aware of and in compliance with such.

- Sacramento County prohibits drones within county parks outside of designated areas unless express permission is obtained from the Director. SCC 1607 § 4.
- Orange County forbids the use of drones in all county parks, beaches, and recreational areas "except in areas designated and under conditions established by the Director." Ord. No. 99-21, § 2-5-42.
- City of Los Angeles prohibits the takeoff or landing of drones except in specially set aside areas. Ord. No. 153,027, Sec. 63.44.B.8.
- City of Hermosa Beach requires drone operators to pay for and obtain a permit, which must be renewed annually. Ord. No. 16-1363.
- City of Yorba Linda prohibits the takeoff or landing of a drone: (a) outside of a

person's visual line of sight; (b) within 25 feet of another individual, other than the operator or operator's designee; (c) on private property without the consent of the property owner; (d) within 500 feet of any special event or any emergency response without the approval of a temporary use permit by the Community Development Director; (e) that has any type of weapon attached to it; and (f) in violation of any FAA-issued Temporary Flight Restriction or Notice to Airmen. Ord. No. 2017-1047, Ch. 8.52, Sec. 8.52.030.

- City of Malibu requires commercial drone operators to first obtain a filming permit. (*See* https://malibucity.org/DocumentCenter/View/407/Film-Application-and-Permit?bidId=).

Project Location

The location of the project, including the adjacent or surrounding area, can affect which laws, regulations, and restrictions apply in using drones at construction sites. According to the FAA, drone operators must receive authorization to fly drones near airports in controlled airspace prior to operation. Such authorizations come with altitude limitations and may include other operational provisions. If flying in uncontrolled airspace near airports, prior authorization is not required for flights in airspace that remain under 400' above the ground. (*See* https://www.faa.gov/uas/getting_started/where_can_i_fly/airspace_restrictions/flying_near_airports). Interested parties may determine the existence and extent of controlled airspace and other flying restrictions through the B4UFLY application developed by the FAA in partnership with the private company, Aloft. (*See* https://www.faa.gov/uas/getting_started/b4ufly).

To the extent the project is located at or near a school, the chance that drone surveillance or photography could inadvertently capture images or audio of children or unsuspecting adults dramatically increases in comparison to, for example, a commercial warehouse being built hundreds of miles outside of the nearest town or city. As a practical matter, owners and contractors may consider restricting drone usage from occurring during times where students and staff tend to congregate outside, such as before and after school, recess, and the lunchtime break. Having written protocols relating to drone usage discussed and approved prior to construction (e.g., at the pre-construction meeting) may assist the parties in avoiding or at least mitigating complaints and other issues related to drone usage on the project.

Similar concerns exist for projects in or adjacent to residential neighborhoods. Although likely not required, owner and contractors may consider circulating flyers to adjacent and surrounding neighbors and posting on community websites and social media forums that construction is or will be commencing during certain times of day for an estimated duration, which includes the use of drones. Additionally, owners and contractors can consider whether certain times of the workday should be utilized or avoided in order to avoid capturing images or audio of children and adults.

Virtually everyone knows that the world-famous Disneyland Resort and theme park is located in Anaheim, California. What may be less well-known is that the FAA has declared that a three nautical mile radius of "National Defense Airspace" exists over Disneyland, which prohibits drones from being operated in this area absent the requisite waivers. (*See* https://tfr.faa.gov/save_pages/detail_4_3635.html).

Weather Conditions

Part 107 requires the remote pilot in command to assess prior to flight, among other things, local weather conditions. §107.49(a)(1). Although required, assessing weather has practical implications as the ability of drones to fly or maintain flight may depend on the weather conditions. Some construction professionals have reported that extremely warm temperatures (110° F or hotter) can prevent drones from flying. Extremely cold temperatures or rain may similarly affect drone performance. Other construction professionals have reported that windy conditions may affect drone usage as well.

In addition to understanding the weather conditions, construction professionals utilizing drones in connection with construction projects should also make sure they know and comply with any manufacturer's guidelines and recommendations.

Conclusion

Regulations and laws relating to drone usage exist at the federal, state, and local levels, necessitating evaluation by construction professionals in connection with each construction project. Where a project is located, including what is near or adjacent to it, may have a significant effect on which laws and regulations apply. All applicable rules should

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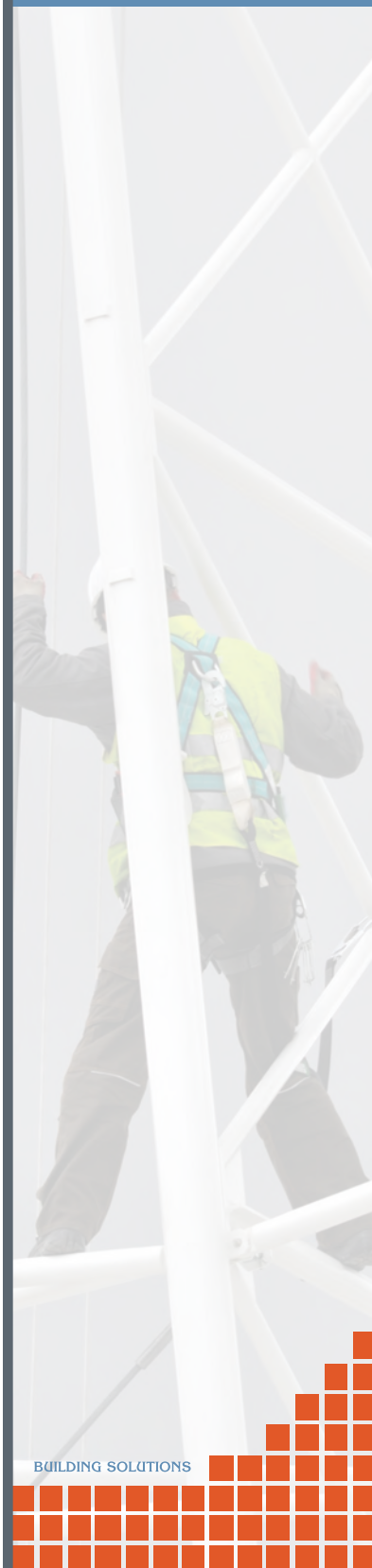

be identified, reviewed, and complied with, or the applicable waiver obtained, as appropriate. Finally, assessing the current and anticipated weather conditions at a construction site is not only required, but will better ensure the desired drone performance and avoid or minimize weather-related issues.

Although non-exhaustive, evaluating these 5 areas will better help construction professionals avoid or at least minimize legal skirmishes relating to drone usage at California construction sites.

California Case Update: The Continued Evolution of California's Prompt-Payment Laws

by Christopher M. Bunge, Partner

In its recent decision, *Vought Construction, Inc. v. Stock*, 84 Cal. App. 5th 622 (2022), a California appellate court provided further clarity on California's prompt-payment statutory scheme. Specifically, the court reviewed the competing interests of an owner's right to withhold liquidated damages from a contractor and the public policy behind the prompt payment statutes. The court found that the withholding of liquidated damages did not violate the prompt-payment statutes so long as that withholding was based on a good faith dispute.

Vought Construction, Inc. ("Vought") appealed from a judgment following a bench trial on its claims against homeowner Jay Stock. Vought sought recovery of the balance due on its contract for the renovation of Stock's house, additional compensation pursuant to a disputed change order, and penalties for the violation of California's prompt-payment statute, Civil Code section 8800. Stock did not dispute the unpaid amount Vought had earned for finished work under the terms of their agreement as modified by approved change orders, but he disputed the claim for additional compensation and asserted an offsetting claim for liquidated damages for delay. The trial court held that Vought was entitled to the undisputed balance due plus approximately half the disputed amount it claimed in additional compensation; and that Stock was entitled to approximately half the amount he claimed as liquidated damages. But most importantly, the trial court determined that Stock had not violated section 8800 by withholding final payment pending resolution of his dispute with Vought.

Civil Code section 8800 requires the owner to pay its direct contractor any progress payment due as to which there is no good faith dispute within 30 days of its receipt of a notice demanding payment pursuant to the contract. If there is a good faith dispute as to that progress payment, however, the owner is permitted to withhold 150 percent of the disputed amount.

Vought's argument to the appellate court was that Stock did not dispute that Vought had earned the claimed contract balance. Since there was no dispute as to those earned funds, Stock's failure to timely make payments pursuant to section 8800 entitled Vought to collect prompt-payment penalties. To support this argument, Vought relied on the recent California Supreme Court's decision in *United Riggers & Erectors, Inc. v. Coast Iron & Steel Co.* 4 Cal. 5th 1082 (2018). In *United Riggers*, which considered disputed change order requests between a contractor and subcontractor, the California Supreme Court determined that the prompt payment statutory scheme was remedial in nature to ensure contractors are not at the mercy of those upon whom they depend for payment. Consistent with this purpose, the court held that a direct contractor could delay payment when the sufficiency of the subcontractor's construction-related performance is the subject of a good faith dispute "when liens or other demands from third parties expose the direct contractor to potential double payment, or when payment would result in the subcontractor receiving more than the minimum amount both sides agree is due." *United Riggers*, 4 Cal. 5th at 1097. However, and critical to Vought's argument, the court held that a contractor could not withhold retention simply because a dispute arose relating to whether additional amounts may be due and owing. "In effect, the payor must be able to present a good faith argument for why all or a part of the withheld monies themselves are no longer due." *Id.* (emphasis added).

The *Vought* court, after considering the *United Riggers* decision, found that Stock did not violate section 8800 by offsetting undisputed amounts due with a claim for liquidated damages. The appellate court agreed with the trial court, which found that Stock had a justifiable claim for liquidated damages since Stock was able to demonstrate that the project was completed late. Moreover, Stock was able to rely on the language of its contract with *Vought*, which explicitly provided that approval of an application for payment may be withheld based on "reasonable evidence that the Work will not be completed within the Contract Time, and that the unpaid balance would not be adequate to cover actual or liquidated damages for the anticipated delay . . . ."

In *United Riggers*, the California Supreme Court set a clear rule that a timely payment may be excused only when the contractor has a good faith basis for contesting the subcontractor's right to receive the specific payment that is withheld. The *Vought* court clarifies that holding by allowing an owner to avoid prompt payment penalties when the owner has a good faith offset to the otherwise undisputed amounts. Additionally, the reliance on an explicit contractual right to support the offset was of particular importance to the *Vought* court and serves as a reminder to all parties to act within the bounds of their contracts. The *Vought* decision, along with the decision in *United Riggers*, provides a clear map for owners, contractors, and subcontractors to navigate California's prompt-payment statutory scheme.

California Court Sharpens The "Sword" And Strengthens The "Shield" Of Contractors' License Law

by Kyle S. Case, Associate

California has become well known for its imposition of "strict and harsh" penalties for a contractor's failure to maintain proper licensure. It is now well understood by most in the construction industry that performing construction work without the necessary license can have significant repercussions on a contractor's business. In the realm of public works projects, any contract with an unlicensed contractor is deemed void. *See* Business & Professions Code Section 7028.15(e). On private projects, California's Contractors' License Law prohibits contractors from maintaining any action to recover payment for their work, and more severe, may require a contractor to disgorge all funds paid to it for performing unlicensed work. *See* Business & Professions Code Section 7031). These methods of deterrence are referred to as the "shield" and "sword" of the Contractors' State License Law. *Loranger v. Jones*, 184 Cal. App. 4th 847, 854 (2010).

In any discussion surrounding licensure, it is important to review the language of the Business and Professions Code ("Bus. & Prof."). Section 7031(a) states:

> Except as provided in subdivision (e), no person engaged in the business or acting in the capacity of a contractor, may bring or maintain any action, or recover in law or equity in any action, in any court of this state for compensation for the performance of any act or contract where a license is required by this chapter without alleging that they were a duly licensed contractor at all times during the performance of that act or contract regardless of the merits of the cause of action brought by the person...

Bus. & Prof. Code § 7031(b) states:

> Except as provided in subdivision (e), a person who utilizes the services of an unlicensed contractor may bring an action in any court of competent jurisdiction in this state to recover all compensation paid to the unlicensed contractor for performance of any act or contract.

Until recently, many were left wondering the consequence, if any, these rules of

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deterrence would have on a contractor if one of its subcontractors was not duly licensed. Would a contractor be required to disgorge its contract funds to a project owner if one of its subcontractors is unlicensed? Would a contractor be able to turn to the courts to recover compensation for the services performed by an unlicensed subcontractor? These important questions have now been answered in the recent decision in *Kim v. TWA Construction, Inc.*, 78 Cal. App. 5th 808 (2022).

Factual Background

In *Kim*, Sally Kim and Dai Trong ("Kim") hired TWA Construction, Inc. ("TWA") to construct a home. The parties' contract required the removal of trees, including a large eucalyptus tree, which, unbeknownst to Kim, partially resided on Kim's neighbor's property. TWA hired a tree trimmer, Marvin Hoffman, who was unlicensed to perform the tree removal work. During the trimming of the tree, Kim's neighbor ordered Mr. Hoffman to cease his work. Later, Kim terminated the contract with TWA due to their inability to secure a construction loan.

The neighbor brought suit against Kim and TWA for wrongfully cutting the tree. In response, Kim filed a cross-complaint against TWA for indemnity and breach of contract. TWA likewise brought a cross-complaint against Kim for breach of contract.

Before trial, Kim filed a motion which sought to require TWA to make an offer of proof as to Hoffman's license status. Kim argued that "unless TWA could prove the subcontractor it hired for the tree work had the requisite license, TWA was barred from recovering from Kim and Truong any money paid or owed to the unlicensed subcontractor," and argued that without its subcontractor maintaining a contractor's license, TWA should disgorge the $10,000 they had paid for tree work since it was performed by an unlicensed subcontractor. The court granted the motion and at trial, TWA failed to introduce evidence of Hoffman's licensure.

Following the trial, judgment was entered in Kim's favor where it was awarded $10,000 in disgorgement from TWA for the amount it paid to TWA for the tree trimming work, and the court found in favor of Kim as to TWA's cross-complaint. TWA subsequently appealed the judgments, arguing, among other things, that the trial court's pre-trial ruling on the application of Bus. & Prof. Code § 7031 erred as a matter of law.

Appellate Court Ruling

The appellate court rejected TWA's argument that the trial court ruling "effectively caused TWA to forfeit its claim for compensation from [Kim] for the tree work." In doing so, the appellate court emphasized California's "legislative determination that the importance of deterring unlicensed persons from engaging in the contracting business outweighs any harshness between the parties." (citing *Lewis & Queen v. N.M. Ball Sons* 48 Cal. 2d 141, 151 (1957)) "[The legislation's] purpose [...] is to provide some assurance that persons offering contractor services in California meet baseline qualifications and discourage noncompliance with the licensing law." The court also stated that "to narrowly construe section 7031(a) to allow TWA's claim for compensation to proceed under the circumstances here [...] would undermine certain other provisions of the statutory scheme governing contractor licensing and contravene the policy behind the statute." Moreover, the court understood that permitting TWA to "recover compensation for the performance of unlicensed work, simply because the work was accomplished by hiring a subcontractor, would circumvent the purpose of section 7031."

With the policy behind Section 7031 guiding its decision, the court confirmed that "it would be unreasonable to permit TWA to collect compensation for work performed by an unlicensed subcontractor when all facets of the Contractors' State License Law are directed at ensuring licensing compliance."

In sum, as a result of TWA's use of an unlicensed subcontractor, TWA was barred from maintaining an action to recover payment and was further required to disgorge all sums paid to it for the unlicensed subcontractor's work.

Conclusion

The case is a reminder to owners, contractors, and subcontractors alike that California courts place great emphasis on the policy behind Section 7031 and will seek to protect the public from "incompetence and dishonesty" in those who provide building and construction services. California contractors must use prudence before entering into subcontracts to ensure their subcontractors are properly licensed. Importantly, however, the *Kim* holding indicates that while a contractor who utilizes an unlicensed subcontractor may be required to disgorge funds, such disgorgement may be limited to the amounts paid for *that*

subcontractor's scope of work, as opposed to *all* sums paid to the contractor for the project.

Additionally, while some aspects of Section 7031 have now been resolved, the *Kim* holding raises new questions. Will this ruling impose a new duty on contractors to ensure their subcontractors are duly licensed throughout their time on the project? What impact will Section 7031 have on a contractor if a subcontractor's license lapses during the performance of its work on the project? While the answers to these questions are currently unknown, if the *Kim* decision is any indication, California contractors should act cautiously, understand California's tendency to uphold its strict licensing laws, and act diligently to monitor their subcontractors' license status.

FIRM NEWS

Honors

U.S. News and World Report - Best Law Firms 2023

Watt, Tieder, Hoffar & Fitzgerald, L.L.P. is once again ranked as a Tier 1 Law Firm by U.S. News and World Report. **Watt Tieder** is ranked as a Tier 1 Firm nationally in Construction Law and Construction Litigation. **Watt Tieder** is also recognized as a Tier 1 Firm in Washington, D.C., Orange County, California and Boston, Massachusetts for Construction Law and Construction Litigation. **Watt Tieder** is also ranked as a Tier 2 Firm in Washington, D.C. in Bankruptcy and in Miami in Construction Litigation, and as a Tier 3 Firm in Boston in Commercial Litigation.

U.S. News and World Report - Best Lawyers 2023

The following **Watt Tieder** attorneys were named among the **Best Lawyers** in America for 2023: **Kathleen O. Barnes** (Construction Law, Litigation-Construction); **Christopher J. Brasco** (Construction Law, Litigation-Construction); **Jonathan C. Burwood** (Construction Law, Litigation-Construction); **Bradford R. Carver** (Commercial Litigation, Construction Law, Litigation-Construction); **Shelly L. Ewald** (Construction Law, Litigation-Construction); **Vivian Katsantonis** (Construction Law); **Jennifer L. Kneeland** (Litigation – Bankruptcy); **Mariela Malfeld** (Litigation – Construction); **Robert C. Niesley** (Construction Law, Litigation-Construction); **Edward J. Parrot** (Litigation – Construction); and **Carter B. Reid** (Construction Law, Litigation-Construction).

Bradford R. Carver was also named Lawyer of the Year in the Construction Law and Litigation-Construction categories in Boston.

Best Lawyers is the oldest and most respected peer-review publication in the legal profession. A listing in ***Best Lawyers*** is widely regarded by both clients and legal professionals as a significant honor, conferred on a lawyer by his or her peers. The lists of outstanding attorneys are compiled by conducting exhaustive peer-review surveys in which tens of thousands of leading lawyers confidentially evaluate their professional peers.

Watt Tieder is proud to announce that Senior Partner **Shelly L. Ewald** has been elected to serve as President of the American College of Construction Lawyers ("ACCL") and will have the honor of presiding over the 35 year anniversary of the College. Founded in 1989, the ACCL is an invited association of construction law practitioners, professors, and judges whose mission is to improve and enhance the practice and understanding of construction law through its professional meetings, educational programs, and publications which serve to bring together

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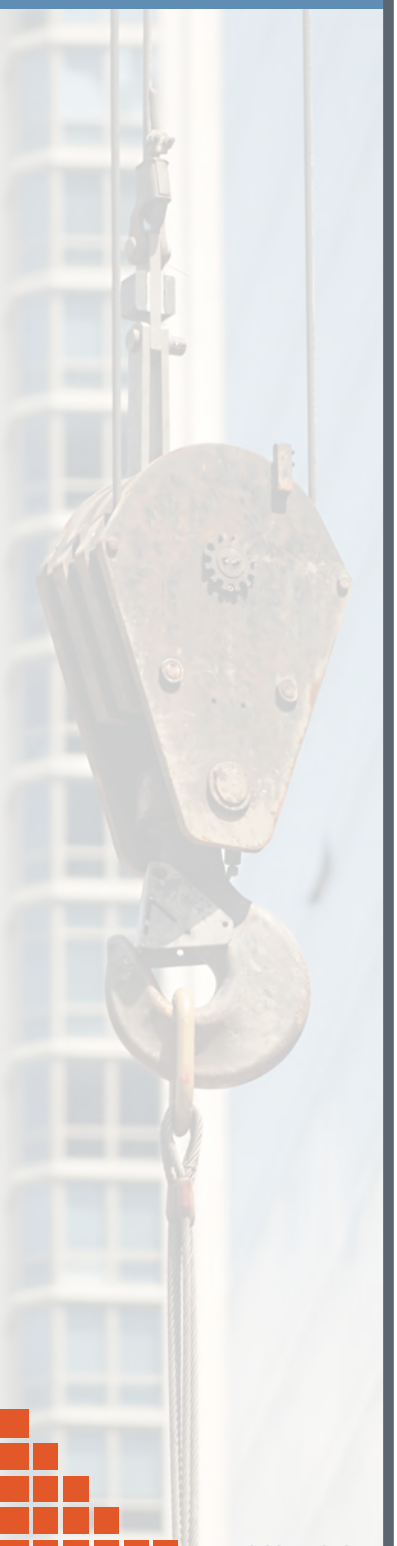
outstanding construction law and industry experts and to promote the positive role of lawyers.

Shelly was first inducted into the ACCL as a Fellow in 2014 after demonstrating skill, experience and high standards of professional and ethical conduct in the practice and teaching of construction law, as well as a dedication to excellence in the specialized practice of construction law. Shelly is one of just 15 members of the ACCL in Virginia. She has served on the Board and Membership Committee and, for the past 3 years, as a member of the Executive Committee. She is joined by fellow Senior Partner **Kathleen O. Barnes** who is also a member of the College and who currently serves on the Membership Committee, **Partner Emeritus Lewis Baker** and the late **John Tieder** and **Julian Hoffar**.



Recent And Upcoming Events

Virginia State Bar 43rd Annual Construction Law and Public Contracts Seminar 2022, November 4, 2022. **Hanna L. Blake** co-presented on "Construction Economic Forecast / Supply Chain Impacts."

National Association of Surety Bond Producers (NASBP), November 30, 2022; Webinar. **C. William Groscup** and **Matthew D. Baker** presented a program titled "Scollick Decision Provides Surety Industry with Important Insights for Avoiding FCA Liability."

ABA Forum on Construction Law Regional Meeting, December 2, 2022; Washington, D.C. **Matthew D. Baker** co-presented on "Contract Negotiation and Philosophy of Risk Shifting."

37th Annual Construction SuperConference, December 6-7, 2022; Las Vegas, Nevada. **Scott P. Fitzsimmons** and **Kathy O. Barnes** co-presented on a panel titled "In-House Counsel Perspective on Effective Mediation Techniques;" **Robert C. Shaia** and **Lauren E. Rankins** presented in a session titled "Wrongful or Right: What Makes a Proper Termination;" **Brian C. Padove** co-presented on "Damages and Delays in the context of Supply Chain/ Covid Impact."

ABA Tort, Trial and Insurance Section's Fidelity and Surety Law Committee's Mid-Winter Conference, January 19-20, 2022; Washington, D.C. **Vivian Katsantonis** was Program Co-Chair; **Shelly L. Ewald** spoke on "Technical Issues In Delay And Inefficiency Claims;" **Christopher J. Brasco** spoke on "The Evolving Landscape of Construction Risk Management and the Priority of Effectively Handling Change;" **Hanna L. Blake** co-presented on a program titled "The Dream Team: Identifying Experts and the Timing (at claim stage versus litigation stage), and Areas of Expertise Needed to Evaluate Claims;" **Jonathan C. Burwood** spoke on "Defenses Commonly Raised by Indemnitors."

Northern Virginia Bankruptcy Bar Association, March 16, 2023; Fairfax, Virginia. **Jennifer L. Kneeland** and **Marguerite Lee DeVoll** will present on "What Every Surety Wants Bankruptcy Lawyers to Know."

AGC ConsensusDocs, March 22, 2023; Live Webinar. **Christopher J. Brasco** and **John E. Sebastian** will speak on "10 Risk Management Maxims that Will Change Your Approach to Project Delivery."

AACE 7th Annual Northeast Symposium, March 23, 2023; Tysons Corner, Virginia. **Christopher J. Brasco** and **Matthew D. Baker** will present on "Progress is Best Measured One 'Half-Step' At A Time."

34th Annual Southern Surety & Fidelity Claims Conference, March 29-31, 2023; Savannah, Georgia. **Christopher J. Brasco** and **Mariela Malfeld** will speak on "Mediation Uncompromised: Achieving Objectives and Avoiding Reflexive Concessions."

American Bankruptcy Institute's Annual Spring Meeting, April 20-22, 2023; Washington, D.C. **Marguerite Lee DeVoll** will speak on "Everything You Ever Wanted to Know about the Intersection of Construction Law in Bankruptcy."

The Maryland Bankruptcy Bar Association's Twenty-Fifth Annual BBA Spring Break Weekend, May 4-5, 2023; Annapolis, Maryland. **Jennifer L. Kneeland** will present on "Digital Assets in Bankruptcy Cases," and **Marguerite Lee DeVoll** will present on "Hot Topics in Business Bankruptcy Cases: Construction and Surety Issues."

American Bar Association – TIPS Spring Program, May 10-12, 2023; Lake Tahoe, Nevada. **Jennifer L. Kneeland** and **Marguerite Lee DeVoll** will present on "Bankruptcy and Payment Bonds: Strategies and Considerations for Protecting Surety Rights and Maximizing Recovery in Bankruptcy."

Western States Surety Conference 2023, May 18-19, 2023; Seattle, WA. **Christopher M. Bunge** and **Kaitlyn M. Linsner** will speak.

Watt Tieder Welcomes New Associates

Christian VanDenBerghe joined **Watt Tieder** in the fall of 2022 as an Associate in its Irvine office. Christian focuses his practice in all areas of construction litigation and transactions, including suretyship and lending.

Prior to joining the firm, Christian was with Jones Day as part of its business and tort litigation team. Christian also has experience in the areas of employment law, consumer credit litigation, and business litigation.

Christian has represented clients in a variety of construction disputes including public works infrastructure litigation, Cal-Trans disputes, hospitals and hospitality projects, multi-family projects, Miller Act claims, and indemnity claims.

Publications

The Surety's Indemnity Agreement: Law and Practice, 3d Ed., **Jonathan C. Burwood**, Co-Author, Chapter IX: Defenses (November 29, 2022). (https://www.americanbar.org/products/inv/book/427744552/)

NFPA Fire Protection Handbook, 21st Ed., **Jonathan C. Burwood**, Chapters 1-4: Legal Issues for Design and Enforcement Professionals (March 3, 2023). (https://catalog.nfpa.org/Fire-Protection-Handbook-21st-Edition-P22371.aspx)

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**

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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, **Timothy E. Heffernan, William Groscup, Christopher M. Harris** and **Marguerite Lee DeVoll**.

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