THE SEMINAR GROUP—CALIFORNIA CONSTRUCTION LAW
Topic: California Construction Law-New Developments
Date and Time: January 19, 2017 at 9:10 a.m.
Speakers: Kevin A. Dorse, Esq. and Erich R. Luschei, Esq.

Kevin A. Dorse is the managing partner at Theodora Oringher, PC. He has been representing business and government clients for over 20 years focusing on complex commercial litigation in a wide variety of industries and issues, including contract disputes, class actions, intellectual property, product liability, insurance coverage, health care, and construction. Kevin heads the Firm's Construction Disputes Group specializing in heavy construction, structures, tunneling, pipelines, and engineering disputes. Kevin has worked on some of the most noteworthy and complex infrastructure projects in Southern California and the country, including the LAUSD and LA Community College school bond construction programs, the LACMTA Hollywood/Vermont Redline Subway Tunnels, the MWD Inland Feeder Project and Arrowhead Tunnels, the Exposition Light Rail Line, 210 Freeway Extension, North Hollywood Redline Subway Tunnels, and Prudhoe Bay Oil Field. Clients choose Kevin for the breadth and quality of his experience, his focus on client-service, and his pragmatic approach to commercial and construction disputes. Prior to joining Theodora Oringher PC, Kevin was a partner with the law firm, Jones Day in Los Angeles. He received his undergraduate degree from Brown University in Providence, Rhode Island where he was Phi Beta Kappa, and his Juris Doctorate degree from the University of Miami School of Law where he was Valedictorian.

Erich R. Luschei is a Senior Attorney at Theodora Oringher PC. His practice focuses on complex construction litigation and transactions with an emphasis on large public works projects. He has practiced in the area of construction for nearly 30 years and has represented owners, contractors, design professionals and prime subcontractors in state and federal courts in the United States and in international arbitrations. Mr. Luschei has worked on some of the largest and most complex construction projects in California, including subways, subway stations, freeways, pipelines, light rail, flood control facilities, and power plant projects. His clients include the Los Angeles Metropolitan Transportation Authority, the City of Long Beach, the County of San Bernardino and County of San Bernardino Flood Control District, the Los Angeles Unified School District, and the Los Angeles Community College District. Mr. Luschei has authored numerous construction related publications and frequently speaks on construction related topics at industry events. He received his undergraduate degree from U.C. Santa Barbara and his law degree from Loyola Law School of Los Angeles.

New Developments in California Construction Law

Kevin A. Dorse
Erich R. Luschei
Theodora Oringher PC

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New Developments

- Tort Duty of Care
- Contractor Licensing
- Taxpayer Standing
- Damages
- Sureties
- Retention
- Competitive Bidding
- Forum Selection Clauses
- Lease-Leasebacks
- Right to Repair
- Settlement and Release
- Review Granted
- New Legislation

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Tort Duty of Care

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Apex Directional Drilling, LLC v. SHN Consulting Eng'rs & Geologists, Inc.

- The case presented the not uncommon scenario where the project engineer serves as the owner's project manager.
- A geotechnical engineering firm provided a geotechnical baseline report for a horizontal directional drilling project, and served as the project manager for the project.
- The contractor based its bid on the GBR, and alleged the conditions encountered differed from those represented in the GBR. The engineer disputed the contractor's assertion of a DSC and recommended to the owner that no additional compensation be provided.
- The owner terminated the contractor and the contractor sued the engineer in tort for economic losses on the project.

Apex Directional Drilling, LLC v. SHN Consulting Eng'rs & Geologists, Inc.

- The engineer moved to dismiss contending it owed no duty to the contractor. The federal court denied the motion, finding that the engineer owed a duty to the contractor in tort based on six factors:
  - the extent to which the transaction was intended to affect the plaintiff;
  - the foreseeability of harm to the plaintiff;
  - the degree of certainty that the plaintiff suffered an injury;
  - the closeness of the connection between the defendant's conduct and the injury suffered;
  - the moral blame attached to the defendant's conduct; and,
  - the policy of preventing future harm.

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Apex Directional Drilling, LLC v. SHN Consulting Eng'rs & Geologists, Inc.

- *Apex* relied on *Beacon Residential Community Association v. Skidmore, Owings & Merrill LLP*, 59 Cal. 4th 568 (2014), holding that a principal architect owes a duty of care to future homeowners.
- Before *Apex*, California case law usually did not support tort duties between project participants on commercial projects.
  - *Fru-Con Const. Corp. v. Sacramento Mun. Utility Dist.*, 2005 WL 1865499 (E.D. Cal. Aug. 3, 2005) (design engineer for power plant owes no tort duty of care to general contractor).
  - *Weseloh Family Ltd. Partnership v. K.L. Wessel Const. Co.*, 125 Cal. App. 4th 152 (2004) (engineers owed no duty of care to property owner and general contractor in connection with alleged negligent design which caused retaining walls to fail).
  - *The Ratcliff Architects v. Vanir Const. Management, Inc.*, 88 Cal. App. 4th 595 (2001) (construction manager owed no duty of care to architect in connection with alleged mismanagement of school renovation project).

Contractor Licensing

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Judicial Council of California v. Jacobs Facilities, Inc., 239 Cal. App. 4th 882 (2015)

- A prominent construction and engineering firm entered into contract for maintenance and repair of multiple facilities with the JCC. During the contract, reorganized its business by internally assigning its personnel and contracts to a related entity.
- The contractor's RMO withdrew before the contract work was completed and became the RMO for the related company. By law, the RMO's withdrawal resulted in the contractor being unlicensed during the term of the contract.
- Even though it knew the contractor had been unlicensed during the contract term, the JCC agreed to a formal assignment of its contract to the new entity. It then sued the contractor for disgorgement of the more than $18 million that it had paid for the work.

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Judicial Council of California v. Jacobs Facilities, Inc., 239 Cal. App. 4th 882 (2015)

- A jury found that the contractor had maintained a license at all times during the contract, and had internally assigned the contract as part of the reorganization.
- The trial court entered a judgment in favor of the contractor, and denied JCC's motion for a JNOV. The Court of Appeal reversed and remanded for trial on the issue of substantial compliance which had been bifurcated.
- The court held that sections 7031(a) and 7031(b) of the Business & Professions Code requires a contractor to be licensed "at all times during the performance of" a contract. The court rejected the contractor's arguments against liability:
  - the CSSL was not applicable to a mere change in the form of business;
  - the internal assignment of the contract with JCC prevented a violation of the CSSL; and
  - the JCC had ratified the assignment retroactively.

Jeff Tracy, Inc. v. City of Pico Rivera, 240 Cal. App. 4th 510 (2015)

- A city awarded a public works contract pursuant to a solicitation requiring a Class A license. The contractor represented in its bid that it had a Class A license, as well as a Class C-27 license.
- After completion of the work, the contractor sued the owner for withholding of liquidated damages. The city cross-complained for disgorgement of the $5.5 million it paid for the work, contending that the Class A license was invalid because the contractor used a sham RME to procure it.
- The trial court rejected the contractor's demand for a trial by jury and entered judgment for the city after a bench trial.
- The Court of Appeal reversed, concluding that the contractor had a right to trial by jury.

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Jeff Tracy, Inc. v. City of Pico Rivera, 240 Cal. App. 4th 510 (2015).

- The Court of Appeal rejected trial court's determination that licensure is a special defense permitting a bench trial under section 597 of the Code of Civil Procedure.
- The court held that a contractor seeking damages must allege and prove that it held a valid license before it can prosecute any claim for damages.
- Because the city required a Class A license pursuant to section 3300 of the Public Contract Code, the court rejected the contractor's argument that it lawfully could perform the work under its Class C-27 license.
- The court also rejected the contractor's argument that damages should be apportioned to permit it to recover for work it was allowed to perform under Class C-27 license.

Taxpayer Standing

San Bernardino County v. Superior Court, 239 Cal. App. 4th 679 (2015)

- Relying on section 1090 of the Government Code, which renders void contracts made by a public entity in which its officers or employees have a financial interest, two taxpayer organizations challenged a $102 million settlement made by the county.
- The plaintiffs alleged that a former supervisor who provided the deciding vote on the settlement had received bribes in the form of political contribution, and sought disgorgement of the $102 million settlement payment.
- The county demurred to the complaint contending that the taxpayer organizations lack standing to contest the settlement. The trial court overruled the demurrer, and the county filed a petition for writ of mandate, which was granted.

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San Bernardino County v. Superior Court, 239 Cal. App. 4th 679 (2015)

- Because only parties to an agreement may challenge it under section 1090, the taxpayers did not have standing under that section.
- The taxpayers also lacked standing pursuant to section 526a of the Code of Civil Procedure or common law. Such taxpayer suits only may be brought where the government body has a duty to act and refused to do so, not where the government body has discretion.
- The court also rejected the argument that discretionary decisions are actionable under if they are the result of fraud or collusion on the part of the decision makers. The taxpayers did not allege that present officials were involved in fraud or collusion, and granting leave to amend would have been futile because the settlement agreement was approved by a validation judgment.

McGee v. Balfour Beatty Construction, LLC, 247 Cal. App. 4th 235 (2016)

- Taxpayers sought to invalidate lease-leaseback agreements between a contractor and a school district pursuant to section 1090 of the Government Code and obtain disgorgement of moneys paid to the contractor.
- Plaintiffs alleged that the contractor was financially interested in the lease-leaseback agreements within the meaning of section 1090 because it had other agreements with the District to provide program management, construction management, and preconstruction services, which were integrally related to the lease-leaseback agreement which the contractor was awarded.
- Because of those arrangements, plaintiffs contended that the contractor was a de facto agent of the District for purposes of section 1090.

McGee v. Balfour Beatty Construction, LLC, 247 Cal. App. 4th 235 (2016)

- The trial court sustained demurrers by the contractor and district without leave to amend. The Court of Appeal reversed.
- Following *Davis v. Fresno Unified School Dist.*, 237 Cal. App. 4th 261 (2015), the court concluded that plaintiffs' allegations were sufficient to withstand a demurrer. In *Davis*, the court concluded that substantially similar allegations were sufficient to provide the plaintiffs with standing to pursue claims under section 1090.
- The *McGee* court distinguished *San Bernardino County* because there were no allegations there that any current officials were involved in the asserted wrongdoing, and the settlement agreement being challenged had been approved in a validation action.

Damages

JMR Construction Corp. v. Environment Assessment and Remediation Management, Inc., 243 Cal. App. 4th 571 (2016)

- Following judgment in favor of a contractor against its electrical and plumbing subcontractor, the subcontractor contested the trial court's decisions to use:
  - the *Eichleay* formula to award the contractor extended home office overhead costs; and
  - the modified total cost method to award the contractor damages for disruption.
- The subcontractor appealed both determinations, and the Court of Appeal affirmed the judgment.

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JMR Construction Corp. v. Environment Assessment and Remediation Management, Inc., 243 Cal. App. 4th 571 (2016)

- The court rejected the subcontractor's arguments against using the *Eichleay* formula. The court reasoned that:
  - damages for breach of contract are intended to put the injured party in as good a position as it would have been had performed been rendered;
  - where the fact of damages is certain, the law only requires a reasonable basis of computation to support an award of damages;
  - extended home office overhead costs are a commonly recognized form of damages for delay in California construction cases; and
  - the federal government developed the *Eichleay* formula and it is the exclusive method used to determined damages suffered in federal cases.

JMR Construction Corp. v. Environment Assessment and Remediation Management, Inc., 243 Cal. App. 4th 571 (2016)

- The subcontractor also objected to using the modified total cost method because the Court *Amelco Electric v. City of Thousand Oaks*, 27 Cal. 4th 228 (2002), characterized it as "generally disfavored."
- The court concluded that the modified total cost method previously had been accepted by the California courts, including in *Dillingham–Ray Wilson v. City of Los Angeles*, 182 Cal. App. 4th 1396 (2010), and was an acceptable method for proving damages in construction cases where the conditions for its use are satisfied:
  - the impracticality of proving actual losses directly;
  - the contractor's bid was reasonable;
  - the contractor's actual costs were reasonable; and
  - the contractor was not responsible for the added costs.
- The JMR court considered and rejected EARM's challenge to the sufficiency of the evidence concerning these conditions.

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Sureties

JMR Construction Corp. v. Environment Assessment and Remediation Management, Inc., 243 Cal. App. 4th 571 (2016)

- The subcontractor's surety in *JMR* also appealed a judgment entered against it on the performance bond.
- The surety argued that judgment should be reversed because the contractor was required, as a condition precedent under the bonds, to give (1) a declaration of the subcontractor's default and (2) notice to the surety of the default. The surety argued that the contractor's obligations to do so were implied conditions precedent under the bonds.
- The Court of Appeal disagreed with the surety's argument and affirmed the judgment.
- The court recognized that conditions precedent are disfavored and will not be implied into a contract unless required by clear, unambiguous language, and particularly not where a forfeiture would be involved or inequitable consequences would result.

JMR Construction Corp. v. Environment Assessment and Remediation Management, Inc., 243 Cal. App. 4th 571 (2016)

- Conditions precedent could not be implied here because:
  - no provision in the underlying subcontracts required notice to the surety;
  - the subcontracts provided that the surety need not be advised of any changes, additions, or omissions;
  - there was no express provision in the bonds expressly limiting the surety's liability on a prior declaration of default or requiring the contractor to provide the surety with notice of the default;
  - Civil Code section 2807 provides that "[a] surety who has assumed liability for payment or performance is liable to the creditor immediately upon the default of the principal, and without demand or notice."

Retention

Blois Construction, Inc. v. FCI/Fluor/Parsons, 245 Cal. App. 4th 1091 (2016)

- The contractor on a public works project subcontracted underground work. Both the prime contract and subcontract permitted withholding of retention. The prime contract further provided that the owner could elect not to retain further sums after 50% of the work was completed, and the owner ceased doing so. However, the owner did not release the retention withheld prior to that time.
- The subcontractor finished its work before the project was completed, at which time the contractor had withheld over $500,000 in retention.
- The subcontractor filed suit against the contractor, alleging that the contractor had wrongfully withheld retention, and the contractor subsequently released the retention.

Blois Construction, Inc. v. FCI/Fluor/Parsons, 245 Cal. App. 4th 1091 (2016)

- The trial court determined that the subcontractor was not entitled to penalties under section 7107 of the Public Contract Code because the contractor had paid the subcontractor's retention before the owner paid retention to the contractor.
- The Court of Appeal affirmed the judgment, concluding that the decision by the owner to stop withholding future retention was not equivalent to a payment by the owner of past retention pursuant to section 7107.
- Because the contractor paid the subcontractor's retention before the owner paid retention to the contractor, the subcontractor was not entitled to penalties for late payment of retention.

Competitive Bidding

Construc. Indust. Force Account Council, Inc. v. Ross Valley Sanitary Dist., 244 Cal. App. 4th 1303 (2016)

- A sanitary district established a program to replace 139 miles of aging sewer line using a pipe bursting technique carried out by its own forces.
- A trade association filed a petition for writ of mandate challenging the district's authority to carry out the work with its own forces.
- Section 20803 of the Public Contract Code provided that "[w]hen the expenditure required for a district project exceeds fifteen thousand dollars ($15,000), it shall be contracted for and let to the lowest responsible bidder after notice." Section 20800 of the Public Contract Code provided that "[t]he provisions of this article shall apply to contracts by sanitary districts."
- The trial court granted the petition after determining that section 20803 was a force account limit statute that precluded the district from using its own forces for projects costing more than $15,000. The trial court entered a judgment directing the district to cease and desist from carrying out the pipe bursting work with its own forces and directing the district to let out all such work by means of competitive bidding.

Construc. Indust. Force Account Council, Inc. v. Ross Valley Sanitary Dist., 244 Cal. App. 4th 1303 (2016)

- The district appealed the judgment and the Court of Appeal reversed.
- Viewing the central issue as one of statutory interpretation, the court agreed with the District that section 20800 only applied to "to contracts" by sanitary districts, not to work the District chose to perform on a force account basis.
- The court also agreed with the District that nothing in section 20803 contained a statutory directive limiting the District's authority to perform work on a force account basis. In the absence of such a directive, sections 20800 and 20803 only could be interpreted to mean that the District was required, if it chose to contract for pipe bursting services exceeding $15,000 with a third party, to let the contract by means of competitive bidding.
- The court also concluded that nothing in its interpretation ran afoul of principles of competitive bidding because a public entity choosing to use its own forces for construction would not be likely to engage in favoritism, improvidence, extravagances, fraud or corruption, which is the concern motivating competitive bidding laws.

Forum Selection Clauses

Vita Planning & Landscape Architecture, Inc. v. HKS Architects, Inc., 240 Cal. App. 4th 763 (2015)

- Vita involved the application of California's statutory prohibition on forum selection clauses in contracts for California projects that require subcontractors to resolve their disputes with contractors.
- Section 410.42(a) of the Code of Civil Procedure renders void and unenforceable provisions of a contract between a contractor and a California-based subcontractor for the construction of a public or private work of improvement in this California "which purports to require any dispute between the parties to be litigated, arbitrated, or otherwise determined outside this state," or "which purports to preclude a party from commencing such a proceeding or obtaining a judgment or other resolution in this state or the courts of this state."
- A California landscape design subcontractor hired by a project architect sued to recover unpaid invoices. The architect moved to dismissed the lawsuit because the subcontract incorporated a forum selection clause required all disputes to be resolved in the Texas courts.

Vita Planning & Landscape Architecture, Inc. v. HKS Architects, Inc., 240 Cal. App. 4th 763 (2015)

- The trial court granted the motion, concluding that the forum selection clause was enforceable and section 410.42 of the Code of Civil Procedure was inapplicable because the dispute involved design professionals, not a contractor and subcontractor.
- The Court of Appeal reversed. Observing that section 410.42 does not define the terms "contractor" or "subcontractor," and contains no language restricting its application to "builders" or licensed contractors, the court adopted a broad definition of the term "contractor" from Black's Law Dictionary to mean "'one who contracts to do work or provide supplies for another.'"
- The court also defined the term subcontractor to mean "'[o]ne who is awarded a portion of an existing contract by a contractor" as provided in Black's Law Dictionary, and "a contractor that does not have a direct contractual relationship with an owner" as provided in section 8046 of the Civil Code.

Lease-Leasebacks

McGee v. Balfour Beatty Construction, LLC, 247 Cal. App. 4th 235 (2016)

- Taxpayers challenged lease-leaseback agreements between a contractor and a school district, seeking disgorgement of moneys paid to the contractor.
- The taxpayers alleged that the lease-leaseback agreements were shams intended to avoid competitive bidding requirements and were void.
- The trial court sustained demurrers filed by the contractor and district and entered a judgment finding that the lease-leaseback agreements were legal, valid and enforceable.
- The Court of Appeal affirmed the judgment concerning the lease-leaseback agreements.
- The court concluded that competitive bidding is not required for lease-leasebacks entered into pursuant to section 17406 of the Education Code.

McGee v. Balfour Beatty Construction, LLC, 247 Cal. App. 4th 235 (2016)

- The court agreed with the decision in *Los Alamitos Unified School Dist. v. Howard Contracting, Inc.*, 229 Cal. App. 4th 1222 (2014), that all that is required to comply with section 17406 is that the district owns the land to be leased, the contractor agrees to construct the project for a guaranteed maximum price, and title to the site, and all improvements made to the project will vest in the district at the end of the lease term.
- The court rejected the decision in *Davis v. Fresno Unified School Dist.*, 237 Cal. App. 4th 261 (2015), which concluded that section 17406 must be construed to require a "genuine" lease-leaseback agreement to avoid subverting competitive bidding.
- The court explained that the district had complied with the typical process for awarding lease-leaseback agreements. The Legislature was familiar with that process and had not amended section 17406 to prescribe other requirements.

Right to Repair Act

Elliott Homes, Inc. v. Superior Court, 6 Cal.App.5th 333 (2016)

- Homeowners filed a lawsuit against a builder for construction defects that had resulted in actual damages to their properties. No pre-litigation notice was given to the builder as provided for in the Right to Repair Act ("Act").
- The builder moved to stay the litigation pursuant to the Act until the pre-litigation process was completed. The homeowners opposed the motion on the basis that they had not alleged any cause of action covered by the Act. The trial court agreed with the homeowners and denied the motion to stay.
- The builder filed a petition for a writ of compelling the trial court to vacate its order, and enter a new order granting the motion for a stay. The Court of Appeal granted the petition.
- The Court of Appeal considered the question of whether the Act, including its pre-litigation procedure, applies when a homeowner pleads construction defect claims based on common law causes of action, and not on statutory violations of the Act's building standards.
- The *Elliott* court concluded that the Act encompasses common law actions and that the homeowners were required to follow the pre-litigation procedure.

Elliott Homes, Inc. v. Superior Court, 6 Cal.App.5th 333 (2016)

- The court based its decision on the provisions of the Act, which expressly
  - apply to any action seeking recovery of damages arising out of, or related to deficiencies in residential construction;
  - limit a homeowner's claims or causes of action to violations of the standards set forth in the Act;
  - provide that no other cause of action for a claim covered by this Act or for damages recoverable under it is permitted; and
  - allow for a recovery for the cost of repairing a building standard violation, or for the cost of repairing any damage caused by such a violation.
- The *Elliott* court also disagreed with *Liberty Mutual Ins. Co. v. Brookfield Crystal Cove, LLC*, 219 Cal. App. 4th 98 (2013), which held that common law construction defect claims arising from actual damages are not covered by the Act.

Settlement and Release

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Belasco v. Wells, 234 Cal. App. 4th 409 (2015)

- After settling a dispute with the defendant builder by means of a settlement agreement with a general release and waiver of known and unknown claims under section 1542 of the Civil Code, a homeowner discovered a defect in the roof, and brought an action against the builder and its surety.
- The defendants moved for summary judgment based on the release, and the trial court granted the motion.
- On appeal, the Court affirmed the judgment.
- The central issue raised in the appeal was whether a latent defect could be the subject of a release under the Right to Repair Act.

Belasco v. Wells, 234 Cal. App. 4th 409 (2015)

- Under section 926 of the Civil Code, one form of resolution of disputes is the builder's repair of claimed defects, but the builder cannot obtain a release or waiver in exchange for the repair work. Instead, following the repair, the homeowner may proceed with an action for violation of statutory standards, and/or for a claim of inadequate repairs.
- However, under section 929 of the Civil Code, the builder can decide not to make repairs and instead resolve the dispute by means of a monetary settlement. In that event, the builder may obtain a reasonable release in exchange for a monetary settlement.
- The Court concluded that section 929 permitted the parties to enter into a reasonable settlement and that the settlement of the first case was reasonable because the plaintiff understood the agreement and was represented by counsel in its negotiation.

Review Granted

United Riggers & Erectors, Inc. v. Coast Iron & Steel Co., S231549

- The California Supreme Court granted review in this case to resolve a split among the courts of appeal regarding the "disputes" for which retention may be withheld under California's prompt payment statutes: section 7107 of the Public Contract Code in the case of public works of improvement, and sections 8810 *et seq*. of the Civil Code in the case of private works.
- These statutes generally require that retention payments be made by owners to general contractors, and general contractors to subcontractors, within 45 to 60 days of completion of the project; however, in the event of a dispute, an amount not to exceed 150 percent of the disputed amount may be withheld pending resolution of the dispute.
- These prompt payment statutes do not define the term "dispute" for which the continued withholding of retention is permitted.

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United Riggers & Erectors, Inc. v. Coast Iron & Steel Co., S231549

- In *Martin Brothers Construction, Inc. v. Thompson Pacific Construction*, Inc., 179 Cal. App. 4th 1401 (2009), the Court of Appeal for the Third Appellate District broadly construed the term dispute to include claims for extra work.
- Subsequently, in *East West Bank v. Rio School District*, 235 Cal. App. 4th 742 (2015), the Court of Appeal for the Second Appellate District disagreed with *Martin Brothers* in holding that a dispute over the contract price does not entitle a public entity to withhold funds due a contractor.
- The California Supreme Court limited review to the following issue: may a contractor withhold retention payments when there is a good faith dispute of any kind between the contractor and a subcontractor, or only when the dispute relates to the retention itself?
- Of note, the *Martin Brothers* decision was authored by the Chief Justice of the California Supreme Court when she was on the Court of Appeal.

McMillin Albany LLC v. Superior Court, S229762

- The Right to Repair Act was enacted in response to the California Supreme Court's decision in *Aas v. Superior Court*, 24 Cal. 4th 627 (2000), which held that construction defects in residential properties were not actionable in tort in the absence of actual property damage.
- Among other things, the Act establishes a pre-litigation process, precludes homeowners from filing suits for construction defects without prior notice to the builder, and permits a stay of litigation until that is done.
- In *McMillin*, homeowners claiming they had suffered property damage as a result of construction defects did not follow the pre-litigation notice process.
- The trial court denied a stay of the action, but the Court of Appeal reversed.
- The issue before the Supreme Court is whether the Right to Repair Act precludes homeowners from bringing common law causes of action for defective conditions that resulted in physical damage, a full circle back to *Aas*.

Sweetwater Union School Dist. v. Gilbane Building Co., S233526

- This case embodies two relatively recent trends in construction litigation.
- First, taxpayers have been challenging contract awards and seeking disgorgement of moneys paid on the basis of section 1090 of the Government Code, which prohibits public officers and employees from having any financial interest in any contract made by them.
  - In some cases like this one, the public entities, prompted by the taxpayers, have brought direction actions under section 1090.
  - The basis for the lawsuit here was that contracts were awarded because the contractor provided school officials with dinners, tickets to sporting events, and travel expenses, and made contributions to political campaigns and charities, in an effort to influence the officials to award the contracts.

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Sweetwater Union School Dist. v. Gilbane Building Co., S233526

- Second, contractors sued under these statutes, as in this case, have been filing anti-SLAPP motions based on the assertion that their conduct, at least in making political contributions, constitutes political expression and petitioning, which is protected by the First Amendment.
  - Evidence offered in opposition to such motions often takes the form of plea agreements, related affidavits supporting the plea, and grand jury transcripts.
- The Supreme Court's review of this decision presents the following issues: (1) Is testimony given in a criminal case by persons who are not parties in a subsequent civil action admissible in that action to oppose a special motion to strike? (2) Is such testimony subject to the conditions in Evidence Code section 1290 et seq. for receiving former testimony in evidence?

Legislative Developments

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Legislative Developments

- NEW CLAIM PROCEDURE FOR PUBLIC WORKS CONTRACTS
  - Not in the written materials.
  - Section 9204 of the Public Contract Code enacted September 29, 2016; effective for all public works contracts made after January 1, 2017.
  - Establishes a new nonwaivable claims resolution procedure that must be included in all contracts.
    - Similar to sections 20104 *et seq*. of the Public Contract Code but not limited to claims of $375,000 or less.
    - Voluntary on the part of contractors.
    - Subcontractors can pass through claims to owners.
    - Owners must review and respond to claims, identifying what is disputed and undisputed, meet and confer regarding claims, and submit to nonbinding mediation.

Legislative Developments

- PUBLIC ENTITIES MUST LIQUIDATE DAMAGES FOR DELAY
  - Section 7203 of the Public Contract Code applies to public works contracts entered into on or after January 1, 2016.
  - Section 7203(a) provides that any public work contract that "contains a clause that expressly requires a contractor to be responsible for delay damages is not enforceable unless the delay damages have been liquidated to a set amount and identified in the public works contract."

Legislative Developments

- LOWERED STANDARD FOR CONTRACTORS SEEKING TO ESTABLISH SUBSTANTIAL COMPLIANCE WITH LICENSURE REQUIREMENTS
  - Section 7031(e) of the Business & Professions Code was amended by AB 1793. AB 1793 was introduced in response to *Judicial Council of California v. Jacobs Facilities, Inc.*, 239 Cal.App.4th 882 (2015).
  - As introduced, AB 1793 would have amended section 7031 to permit a contractor to be paid even if the contractor was not licensed "at all times."
  - As finally approved, AB 1793 revised the criteria for a court to find that a contractor is in substantial compliance with the licensure requirements by removing the condition that the contractor "did not know or should not have reasonably have known, that he or she was unlicensed during performance of the contract."

Legislative Developments

- EXPANSION OF BEST VALUE CONTRACTING
  - Public Contract Code sections 20119 *et seq*. establish a pilot program allowing the Los Angeles Unified School District to use best value procurement, and Public Contract Code sections 20155 *et seq*. establishes a pilot program allowing certain counties to use best value procurement.
- **SCHOOL DISTRICTS AUTHORIZED TO USE JOB ORDER CONTRACTING**
  - Public Contract Code sections 20919.20 *et seq*. authorize school districts statewide to use job order contracting as that term is defined in section 20919.21.

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CASES

- **GEOTECHNICAL ENGINEER OWES A TORT DUTY OF CARE TO A TUNNELING CONTRACTOR FOR CONDITIONS REPRESENTED IN A GEOTECHNICAL BASELINE REPORT:** *Apex Directional Drilling, LLC v. SHN Consulting Eng'rs & Geologists, Inc.*, 2015 U.S. Dist. LEXIS 105537 (N.D. Cal. Aug. 11, 2015).

Apex Directional Drilling, LLC ("Apex") was awarded a contract by City of Eureka ("Eureka") to construct a new wastewater pipeline by means of horizontal directional drilling ("HDD"). Apex based its bid on a geotechnical baseline report ("GBR") that indicated the ground conditions for the project were suitable for HDD. The City's engineering firm and project manager, SHN Consulting Engineers & Geologists, Inc. ("SHN"), had prepared the GBR. During the course of the construction, Apex encountered soils that were not suitable for HDD and contrary to the GBR. Despite repeated efforts to secure additional compensation based on asserted differing site conditions, SHN rejected Apex's contentions, insisting that differing site conditions were not present, and recommended that the City not increase Apex's compensation. Ultimately, the City terminated Apex from the project, and the contractual dispute was ordered to arbitration.

While the arbitration was pending, Apex sued SHN for professional negligence and negligent misrepresentation. SHN moved to dismiss Apex's complaint for failure to state a claim for which relief may be granted. SHN argued that it could not be held liable to Apex in tort because SHN owed no duty of care to Apex.

In denying the motion to dismiss, the *Apex* court determined that SHN owed a duty of care to Apex under California's multi-factor test for determining the existence of a duty in the case of negligence claims seeking economic damages. The six factors are the extent to which the transaction was intended to affect the plaintiff; the foreseeability of harm to the plaintiff; the degree of certainty that the plaintiff suffered an injury; the closeness of the connection between the defendant's conduct and the injury suffered; the moral blame attached to the defendant's conduct; and, the policy of preventing future harm. The court determined that the first, third and fourth factors weighed in favor of imposing a duty of care because the GBR was prepared for the purpose of establishing a baseline upon which Apex would base its bid and mistakes in the GBR and subsequent actions by SHN caused Apex to suffer considerable losses. The court also reasoned that practical considerations supported its determination that SHN owed a duty of care to Apex, as the duty was owed to "a specific, foreseeable and well-defined class" as opposed to creating the potential for "unlimited liability to a nebulous group of future plaintiffs."

With respect to the claim for negligent misrepresentation, the court similarly found that a duty of care existed on the part of SHN to Apex. In particular, the court determined that Apex was a member of a specific class of persons whose decisions (i.e., bidding and pricing) SHN sought to influence by means of the GBR. That was sufficient to give rise to a tort duty of care for a claim of negligent misrepresentation.

The *Apex* case was filed following the California Supreme Court's decision in *Beacon Residential Community Association v. Skidmore, Owings & Merrill LLP*, 59 Cal. 4th 568 (2014), where the Court held that an architect owes a duty of care to future homeowners in the design of a residence where the architect is a principal architect on the project. Earlier case law suggested that tort duties between different project participants generally were incompatible with the construction process. *See, e.g., Fru-Con Const. Corp. v. Sacramento Mun. Utility Dist.*, 2005 WL 1865499 (E.D. Cal. Aug. 3, 2005) (design engineer for power plant owes no tort duty of care to general contractor); *Weseloh Family Ltd. Partnership v. K.L. Wessel Const. Co.*, 125 Cal. App. 4th 152 (2004) (engineers owed no duty of care to property owner and general contractor in connection with alleged negligent design which caused retaining walls to fail); *The Ratcliff Architects v. Vanir Const. Management, Inc.*, 88 Cal. App. 4th 595 (2001) (construction manager owed no duty of care to architect in connection with alleged mismanagement of school renovation project). It did not take long for *Skidmore* to jump the gap from residential construction defect litigation to public works contracting. More *Apex*-type cases can be anticipated on public works projects.

LICENSURE

- **REQUIREMENT THAT CONTRACTOR BE LICENSED AT "ALL TIMES DURING THE PERFORMANCE" OF A CONTRACT APPLIES IN COMPLEX REORGANIZATIONS DESPITE MERE CHANGE IN FORM AND RETROACTIVE ASSIGNMENT OF CONTRACT TO RELATED ENTITY THAT IS LICENSED:** *Judicial Council of California v. Jacobs Facilities, Inc.*, 239 Cal. App. 4th 882 (2015).

Jacobs Facilities, Inc. ("Facilities"), a licensed contractor, entered into a three-year facilities maintenance and repair agreement with the Judicial Council of California (the "JCC") in 2006, pursuant to which Facilities provided administrative and oversight services for work performed by subcontractors with respect to 121 buildings. Later that year, Facilities' parent company, Jacobs Engineering, Inc. ("Engineering"), commenced a reorganization which ultimately resulted in Facilities' employees being transferred to a new subsidiary of Engineering, Jacob Project Management, Co. ("Management"). Work under the contract after the reorganization proceed as it had prior to the reorganization. Facilities, which had not been dissolved, continued to invoice the JCC, execute the work, and provide insurance and bonds in its name. However, the RMO for Facilities voluntarily withdrew in August of 2008 and three days later became the RMO for Management. Facilities' license was suspended in the absence of an RMO and expired in November 2008. As such, Facilities was unlicensed even as services continued to be

performed under its contract with JCC, and pursuant to the exercise of a one-year option signed by JCC and Facilities in February of 2009. Notwithstanding its awareness that Facilities had been unlicensed since August of 2008, JCC agreed in November of 2009 to an assignment of its contract with Facilities to Management. A month later it sued Facilities, Engineering and Management for disgorgement of the more than $18 million that it had paid to Facilities.

A jury trial was conducted, with defense of substantial compliance bifurcated and held in abeyance until after the jury verdict. The jury found by special verdict, among other things, that Facilities had maintained a license at all times during the contract, and that Facilities had internally assigned the contract to Management as part of the reorganization. The trial court entered a judgment in favor of the defendants, and denied JCC's motion for judgment notwithstanding the verdict.

JCC appealed the denial of its motion for JNOV, and the Court of Appeal reversed. Recognizing that sections 7031(a) and 7031(b) of the Business & Professions Code requires a contractor to be licensed "at all times during the performance of" a contract, the court reversed the judgment and remanded for a new trial on the issue of Facilities' substantial compliance under 7031(b) of the Business & Professions Code. The court rejected defendants' argument that they could not be liable under the Contractor State License Law ("CSSL") because the CSSL was not applicable to a mere change in the form of business, the internal assignment by Facilities to Management of the contract with JCC prevented a violation of the CSSL, and that JCC had ratified the assignment from Facilities to Management retroactively.

- **GENERAL CONTRACTOR HAS A RIGHT TO JURY TRIAL ON WHETHER IT WAS PROPERLY LICENSED AND DAMAGES FOR DISGORGEMENT:** *Jeff Tracy, Inc. v. City of Pico Rivera*, 240 Cal.App.4th 510 (2015).

The City of Pico Rivera awarded a public works contract to Jeff Tracy, Inc. The notice inviting bids required bidders to have a Class A license at the time of contract award. In its bid, the contractor represented that it had a Class A license, as well as a Class C-27 license for general landscaping. After the work was completed, the contractor filed suit for breach of contract for the city's withholding of liquidated damages. Subsequently, the city filed a cross-complaint seeking disgorgement of all moneys paid under the contract ($5.5 million) on the basis that the contractor's Class A license was invalid because the contractor used a sham RME to procure it. Over the contractor's objection that it was entitled to a jury trial, the trial court conducted two bench trials. In the first trial, the court determined that the contractor was not duly licensed and the city was entitled to disgorgement. In the second trial, the court determined the amount of the award.

The Court of Appeal reversed, concluding that the contractor had a right to trial by jury on both the issue of licensure and the issue of damages. The trial court denied the contractor a jury trial on the basis of section 597 of the Code of Civil Procedure, which

permits the court to try a special defense constituting a bar or ground for abatement of the plaintiff's complaint in advance of other issues in a case. The contractor argued, and the Court of Appeal held, that the issue of licensure is not a special defense. Instead, a contractor seeking damages must allege and prove that it held a valid license before it can prosecute any claim for damages. Concluding that there were numerous factual issues involving the City's sham RME theory and damages, the court held that the contractor was entitled to a jury trial on both issues.

On appeal, the contractor also presented two other arguments: that its Class C-27 license permitted it to perform the work required by the contract with the city, and that damages should be apportioned to permit it to recover for work it was permitted to perform under that license. The Court of Appeal rejected both arguments. Because the city had specified the required license classification in its notice inviting bids in accordance with section 3300 of the Public Contract Code, the court held that the contractor was required to hold a Class A license. In addition, the court held that section 7031(b) of the Business & Professions Code does not permit apportionment.

TAXPAYER STANDING

- **TAXPAYERS LACKED STANDING UNDER SECTION 1090 OF THE GOVERNMENT CODE WHERE COUNTY HAD DISCRETION TO CHALLENGE AGREEMENT, CHOSE NOT TO DO SO, AND NO PRESENT GOVERNMENT OFFICIALS WERE ALLEGED TO HAVE ENGAGED IN WRONGDOING:** *San Bernardino County v. Superior Court*, 239 Cal. App. 4th 679 (2015).

Two taxpayer organizations filed suit challenging a $102 million settlement made by the County of San Bernardino ("County") under section 1090 of the Government Code, which renders void contracts made by a public entity in which its officers or employees have a financial interest. The plaintiffs alleged that a former supervisor who provided the deciding vote on the settlement had received bribes in the form of political contributions from the party in whose favor the settlement was made, and sought disgorgement of the $102 million settlement payment. The County demurred to the complaint on the grounds that the taxpayer organizations lack standing to contest the settlement, and the trial court overruled the demurrer.

The County filed a petition for writ of mandate to vacate the order overruling its demurrer and to enter an order granting the demurrer without leave to amend. The Court of Appeal granted the petition. The court held that the plaintiffs did not have direct standing under section 1090 because they were not parties to the agreement, as required by section 1090. The court also rejected plaintiffs' argument that they had standing pursuant to section 526a of the Code of Civil Procedure or common law because such taxpayer suits are authorized if the government body has a duty to act and refused to do so, not where, as in this case, the government body has discretion not to act and chooses not to do so. Finally, the court reject the argument that taxpayer suits are permitted

where there are allegations that the failure to act, even when discretionary, are the result of fraud or collusion on the part of the decision makers. The complaint, however, contained no allegations that any present County official was involved in the bribery scheme or otherwise was engaged in fraud or collusion. In addition, granting leave to amend would have been futile because the validity of the settlement agreement was barred by a validation judgment entered after the settlement was made.

- **TAXPAYERS DID HAVE STANDING UNDER SECTION 1090 OF THE GOVERNMENT CODE WHERE ALLEGED WRONGFUL CONDUCT WAS ONGOING:** *McGee v. Balfour Beatty Construction, LLC,* 247 Cal. App. 4th 235 (2016).

As in *San Bernardino County v. Superior Court*, 239 Cal. App. 4th 679 (2015), taxpayers in *McGee v. Balfour Beatty Construction, LLC*, 247 Cal. App. 4th 235 (2016), relied on section 1090 of the Government Code in an effort to invalidate lease-leaseback agreements entered into between a contractor and the Torrance Unified School District and to obtain disgorgement of moneys paid to the contractor pursuant to the agreements. Plaintiffs alleged that the contractor there was financially interested in the lease-leaseback agreements because it had other agreements with the District to provide program management, construction management, and preconstruction services, which were integrally related to the lease-leaseback agreement which the contractor was awarded. Because of those arrangements, moreover, plaintiffs alleged that the contractor were employees or officers of the District for purposes of section 1090. The trial court sustained demurrers of the contractor and the District without leave to amend, and entered a judgment of dismissal.

The Court of Appeal reversed. Following *Davis v. Fresno Unified School Dist.*, 237 Cal. App. 4th 261 (2015), the court concluded that plaintiffs' allegations were sufficient to withstand a demurrer. In Davis, the court concluded that substantially similar allegations were sufficient to provide the plaintiffs with standing to pursue claims under section 1090. The McGee court also distinguished the *San Bernardino County* case because there were no allegations in that case that any current officials were involved in the asserted wrongdoing or otherwise engaged in fraud and collusion, and the settlement agreement being challenged had been approved in a validation action.

DAMAGES

- **THE *EICHLEAY* FORMULA IS A LEGALLY PERMISSIBLE METHOD FOR DETERMINING HOME OFFICE OVERHEAD DAMAGES IN CALIFORNIA:** *JMR Construction Corp. v. Environment Assessment and Remediation Management, Inc.*, 243 Cal. App. 4th 571 (2016).

The Army Corps of Engineers retained JMR Construction Corp. ("JMR") to construct a dental clinic, and JMR subcontracted the electrical and plumbing subcontracts to Environmental Assessment & Remediation Management, Inc. ("EARM"). After

completion of the project, JMR sued EARM for breach of contract and EARM's surety to enforce the performance bond. Following a bench trial, the trial court found in favor of JMR, including for damages for extended home office overhead expenses that were calculated using the *Eichleay* formula.

On appeal, EARM challenged the trial court's acceptance of the *Eichleay* formula as the basis for awarding damages for extended home office overhead, arguing that no California decision had approved the use of that formula. The Court of Appeal rejected EARM's arguments, and affirmed the judgment. In doing so, the court recognized that (i) damages for breach of contract are intended to put the injured party in as good a position as it would have been had performed been rendered, (ii) where the fact of damages is certain, the law only requires that some reasonable basis of computation to provide a reasonable approximation of the losses suffered, (iii) extended home office overhead is a commonly recognized form of damages for delay in construction cases in California, including in cases brought by contractors against their subcontractors for breach of contract, and (iv) the federal government developed the Eichleay formula and it is the exclusive method used to determined damages suffered by a contractor in disputes with the federal government for determination of the costs of extended home office overhead. Accordingly, notwithstanding the absence of any California decision approving the use of the *Eichleay* formula, the trial court was warranted in applying it to determine JMR's damages.

- **THE MODIFIED TOTAL COST METHOD OF PROVING DAMAGES IS PERMISSIBLE IN CALIFORNIA IF THE CONDITIONS FOR ITS USE ARE SATISFIED:** *JMR Construction Corp. v. Environment Assessment and Remediation Management, Inc.*, 243 Cal. App. 4th 571 (2016).

The Army Corps of Engineers retained JMR Construction Corp. ("JMR") to construct a dental clinic, and JMR subcontracted the electrical and plumbing subcontracts to Environmental Assessment & Remediation Management, Inc. ("EARM"). After completion of the project, JMR sued EARM for breach of contract and EARM's surety to enforce the performance bond. Following a bench trial, the trial court found in favor of JMR, including for damages that were calculated using the modified total cost method.

On appeal, EARM challenged the trial court's acceptance of the modified total cost method for proving damages in construction cases. The Court of Appeal rejected EARM's arguments and affirmed the judgment. Notwithstanding the California Supreme Court's characterization in *Amelco Electric v. City of Thousand Oaks*, 27 Cal. 4th 228 (2002), of the total cost method as "generally disfavored," the *JMR* court concluded that the modified total cost method had been accepted by the California courts in *Dillingham–Ray Wilson v. City of Los Angeles*, 182 Cal. App. 4th 1396 (2010), and *State of California ex rel. Dept. of Transp. v. Guy F. Atkinson Co.*, 187 Cal. App. 3d 25 (1986), and was an acceptable method for proving damages in construction cases where the conditions for its use are satisfied. Those conditions are (1) the impracticality of proving

actual losses directly; (2) the contractor's bid was reasonable; (3) the contractor's actual costs were reasonable; and (4) the contractor was not responsible for the added costs. The *JMR* court considered EARM's challenge to the sufficiency of the evidence concerning these conditions, and concluded there was substantial evidence to support the trial court's decision as to each condition.

SURETIES

- **CONDITIONS PRECEDENTS WILL NOT BE IMPLIED INTO THE LANGUAGE OF A BOND REQUIRING THE PRINCIPAL TO GIVE NOTICE OR MAKE DEMANDS:** *JMR Construction Corp. v. Environment Assessment and Remediation Management, Inc.*, 243 Cal. App. 4th 571 (2016).

The Army Corps of Engineers retained JMR Construction Corp. ("JMR") to construct a dental clinic, and JMR subcontracted the electrical and plumbing subcontracts to Environmental Assessment & Remediation Management, Inc. ("EARM"). After completion of the project, JMR sued EARM for breach of contract and EARM's surety to enforce the performance bonds for the two subcontracts. Following a bench trial, the trial court found in favor of JMR, including for damages claimed against the surety.

On appeal, the surety argued that judgment should not have been imposed against it because JMR was required, as a condition precedent under the bonds, to give (1) a declaration of EARM's default and (2) notice to the surety of the default. The surety argued that JMR's obligation to declare a default and provide notice was a necessarily implied condition precedent under the bonds. The Court of Appeal disagreed with the surety's argument and affirmed the judgment. The court recognized that conditions precedent are disfavored and will not be implied into a contract unless required by clear, unambiguous language, and particularly note where a forfeiture would be involved or inequitable consequences would result. No provision in the underlying subcontracts between JMR and EARM, which are to be read in conjunction with the bond, required notice to the surety despite numerous other terms of the subcontracts providing for notice with respect to issues of performance. In fact, the subcontracts provided that the surety need not be advised of any changes, additions, or omissions. In addition, there was no express provision in the bonds expressly limiting the surety's liability on a prior declaration of default or requiring JMR to provide the surety with notice of the default. Accordingly, the JMR court concluded that the bonds did not contain the clear and ambiguous language that would support a finding that JMR was required to declare EAR's default or provide a notice of default to the surety as a condition precedent to its liability under the bonds. Finally, the court observed that under general suretyship law, Civil Code section 2807 provides that "[a] surety who has assumed liability for payment or performance is liable to the creditor immediately upon the default of the principal, and without demand or notice."

RETENTION

- **PUBLIC CONTRACT CODE SECTION 7107 DOES NOT REQUIRE A GENERAL CONTRACTOR TO PAY A SUBCONTRACTOR LATE PAYMENT PENALTIES ON RETENTION IT HAS NOT RECEIVED FROM A PROJECT OWNER:** *Blois Construction, Inc. v. FCI/Fluor/Parsons*, 245 Cal. App. 4th 1091 (2016).

The Exposition Metro Line Construction Authority ("Expo") for the Exposition light-rail line from downtown Los Angeles to Santa Monica retained FCI/Fluor Parsons ("FFP") as the general contractor for the project, and FFP subcontracted with Blois Construction ("Blois") for underground work. Both the prime contract and subcontract permitted withholding of retention. Expo was permitted to withhold 10 percent of the payments owed to FFP, and FFP was entitled to withhold 10 percent of the payments owed to Blois. The prime contract further provided that Expo could elect not to retain further sums after 50% of the work has been completed if it determined that progress on the work was satisfactory. By December 2009, Expo ceased withholding retention from progress payments; however, it did not release to FFP the retention withheld up to that point.

By the time Blois finished its work on the project in 2011, FFP had withheld over $500,000 in retention from Blois. In 2012, Blois filed suit against FFP and its sureties, alleging that FFP had failed to pay Blois for (1) the extra work that Blois performed on the project and (2) the retention it had withheld. Pursuant to FFP's motion, the court referred the case to the DRB for the project for resolution. While the case was still pending before the DRB, FFP paid Blois the full amount that Blois claimed it was owed in retention. The DRB ruled in favor of Blois, finding among other things that under the terms of the subcontract, FFP had been required to pay the retentions it had withheld by September 2011. However, the DRB left it to the trial court to decide whether Blois was entitled to penalties for late payment of retention. After a court trial, the court ruled Blois was not entitled to penalties because Expo had not released the retained funds to FFP until 2014 and FFP had paid Blois the full amount of its retention prior to that time at the end of 2013.

Blois appealed the judgment contending that Expo's decision not to continue withholding retention triggered an obligation on the part of FFP under section 7107 of the Public Contract Code to release the retention that FFP had withheld from Blois. The Court of Appeal affirmed the judgment, concluding that the decision by the project owner to stop withholding future retentions and pay full progress payments to the contractor was not equivalent to a payment by the owner of past retention pursuant to section 7107. Because FFP did not receive any retention proceeds from Expo until 2014, its obligation to pay Blois the retention under section 7107 did not arise prior to that date. Accordingly, the court concluded that Blois was not entitled to penalties for late payment of retention.

COMPETITIVE BIDDING

- **SECTION 20803 OF THE PUBLIC CONTRACT CODE REQUIRING COMPETITIVE BIDDING DOES NOT APPLY WHEN DISTRICT USES ITS OWN WORKFORCE:** *Construction Industry Force Account Council, Inc. v. Ross Valley Sanitary Dist.*, 244 Cal. App. 4th 1303 (2016).

Ross Valley Sanitary District (the "District") is responsible for operating and maintaining 200 miles of sewer collection lines and related infrastructure. The District established a program to replace 139 miles of aging sewer line, which was mostly small diameter (10" or less), using a pipe bursting technique carried out by its own forces.

A trade association consisting of unions and contractors filed a petition for writ of mandate challenging the District's authority to carry out the work with its own forces. Section 20803 of the Public Contract Code, which is applicable to the District, provides in material part that "[w]hen the expenditure required for a district project exceeds fifteen thousand dollars ($15,000), it shall be contracted for and let to the lowest responsible bidder after notice." A related provision, section 20800 of the Public Contract Code, provides in relevant part that "[t]he provisions of this article shall apply to contracts by sanitary districts."

The trial court granted the petition after determining that section 20803 was a force account limit statute that precluded the District from using its own forces for projects costing more than $15,000. The trial court entered a judgment directing the District to cease and desist from carrying out the pipe bursting work with its own forces and directing the District to let out all such work by means of competitive bidding.

The District appealed the judgment and the Court of Appeal reversed. Viewing the central issue as one of statutory interpretation, the court agreed with the District that section 20800 only applied to "to contracts" by sanitary districts, not to work the District chose to perform on a force account basis. The court also agreed with the District that nothing in section 20803 contained a statutory directive limiting the District's authority to perform work on a force account basis. In the absence of such a directive, sections 20800 and 20803 only could be interpreted to mean that the District was required, if it chose to contract for pipe bursting services exceeding $15,000 with a third party, to let the contract by means of competitive bidding. The court also concluded that nothing in its interpretation ran afoul of principles of competitive bidding because a public entity choosing to use its own forces for construction would not be likely to engage in favoritism, improvidence, extravagances, fraud or corruption, which is the concern motivating competitive bidding laws.

FORUM SELECTION CLAUSE

- **SECTION 410.42 OF THE CODE OF CIVIL PROCEDURE PROTECTS CALIFORNIA CONTRACTORS AND SUBCONTRACTORS FROM BEING FORCED TO LITIGATE DISPUTES OUTSIDE CALIFORNIA:** *Vita Planning & Landscape Architecture, Inc. v. HKS Architects, Inc.*, 240 Cal. App. 4th 763 (2015).

Vita involved the application of California's statutory prohibition on forum selection clauses in contracts for California projects that require subcontractors to resolve their disputes with contractors, whether by litigation, arbitration or mediation, outside of California. Section 410.42(a) of the Code of Civil Procedure renders void and unenforceable provisions of a contract between a contractor and a California-based subcontractor for the construction of a public or private work of improvement in this California "which purports to require any dispute between the parties to be litigated, arbitrated, or otherwise determined outside this state," or "which purports to preclude a party from commencing such a proceeding or obtaining a judgment or other resolution in this state or the courts of this state."

Vita grew out of a failed luxury hotel project in California that left the lead architect (HKS) with an uncollectable judgment against the project's Texas owner, and HKS's landscape design subcontractor (Vita) with invoices that went unpaid by HKS. Vita sued HKS in California, among other things, for breach of a subcontract between Vita and HKS that incorporated the dispute resolution provisions of the prime contract between HKS and the owner, including a forum selection clause that required all disputes to be resolved in the Texas courts. Based on the forum selection clause, HKS moved to dismiss Vita's complaint on the basis that the California courts lacked subject matter jurisdiction over the case. The trial court granted the motion, concluding that the forum selection clause was enforceable and section 410.42 of the Code of Civil Procedure was inapplicable because the dispute involved design professionals, not a contractor and subcontractor.

The Court of Appeal reversed. Observing that section 410.42 does not define the terms "contractor" or "subcontractor," and contains no language restricting its application to "builders" or licensed contractors, the court adopted a broad definition of the term "contractor" from Black's Law Dictionary to mean "'one who contracts to do work or provide supplies for another.'" The court also defined the term subcontractor to mean "'[o]ne who is awarded a portion of an existing contract by a contractor" as provided in Black's Law Dictionary, and "a contractor that does not have a direct contractual relationship with an owner" as provided in section 8046 of the Civil Code. Based on these definitions, Vita was a subcontractor and the forum selection clause was unenforceable.

LEASE-LEASEBACKS

- **COMPLIANCE WITH THE STATUTORY LANGUAGE OF SECTION 17406 OF THE EDUCATION CODE IS SUFFICIENT TO AVOID COMPETITIVE BIDDING CHALLENGES TO LEASE-LEASEBACK AGREEMENTS:** *McGee v. Balfour Beatty Construction, LLC*, 247 Cal. App. 4th 235 (2016).

In *McGee v. Balfour Beatty Construction, LLC*, 247 Cal. App. 4th 235 (2016), taxpayers challenged lease-leaseback agreements entered into between a contractor and the Torrance Unified School District and sought disgorgement of moneys paid to the contractor pursuant to the agreements. The plaintiffs alleged that the lease-leaseback agreements were shams intended to avoid competitive bidding requirements and were void. The trial court sustained demurrers filed by the contractor and District and entered a judgment finding that the lease-leaseback agreements were legal, valid and enforceable.

The Court of Appeal affirmed the judgment concerning the lease-leaseback agreements. The court concluded, contrary to plaintiffs' arguments, that competitive bidding is not required for lease-leasebacks entered into pursuant to section 17406 of the Education Code. The court agreed with the decision in *Los Alamitos Unified School Dist. v. Howard Contracting, Inc.*, 229 Cal. App. 4th 1222 (2014), that all that is required to comply with section 17406 is that the District owns the land to be leased, the contractor agrees to construct the Project for a guaranteed maximum price, and title to the site, and all improvements made by the Project will vest in the District at the end of the lease term. The court rejected the decision in *Davis v. Fresno Unified School Dist.*, 237 Cal. App. 4th 261 (2015), which concluded that section 17406 must be construed as requiring a "genuine" lease-leaseback agreement to assure that such agreements are not a subterfuge designed to avoid the requirements of competitive bidding, explaining that the District had complied with the typical process for awarding lease-leaseback agreements the Legislature was familiar with and as to which no amendments had been made to section 17406.

RIGHT TO REPAIR

- **THE PRE-LITIGATION NOTICE REQUIREMENTS OF THE RIGHT TO REPAIR ACT (CIVIL CODE §§ 895 *ET SEQ.*) APPLY EVEN IF THE PLAINTIFFS DO NOT ALLEGE A CAUSE OF ACTION UNDER THE ACT:** *Elliott Homes, Inc. v. Superior Court*, 6 Cal.App.5th 333 (2016).

Homeowners filed a lawsuit against a builder for construction defects that had resulted in actual damages to their properties. No pre-litigation notice was given to the builder as provided for in the Right to Repair Act. The builder moved to stay the litigation pursuant to the Act until the pre-litigation process was completed. The homeowners opposed the motion on the basis that they had not alleged any cause of

action covered by the Act. The trial court agreed with the homeowners and denied the motion to stay.

The builder filed a petition for a writ of compelling the trial court to vacate its order, and enter a new order granting the motion for a stay. The Court of Appeal granted the petition. The Court of Appeal considered the question of whether the Act, including its pre-litigation procedure, applies when a homeowner pleads construction defect claims based on common law causes of action, and not on statutory violations of the Act's building standards. The *Elliott* court concluded that the Act encompasses common law actions and that the homeowners were required to follow the pre-litigation procedure. The court based its decision on the provisions of the Act, which expressly apply to any action seeking recovery of damages arising out of, or related to deficiencies in residential construction, limit a homeowner's claims or causes of action to violations of the standards set forth in the Act, provide that no other cause of action for a claim covered by this title or for damages recoverable under it is permitted, and allows for a recovery for the cost of repairing a building standard violation, or for the cost of repairing any damage caused by such a violation.

The *Elliott* court also disagreed with the court's decision in *Liberty Mutual Ins. Co. v. Brookfield Crystal Cove, LLC*, 219 Cal. App. 4th 98 (2013). In that case, a homeowner's insurer paid for living expenses of a homeowner who was required to move to a hotel after pipes in a sprinkler system broke and caused substantial damage to the property. The trial court there sustained the builder's demurrer to the complaint on the ground that it was time-barred under the Act. The *Liberty Mutual* court reversed, holding that common law construction defect claims arising from actual damages are not covered by the Act.

SETTLEMENT AND RELEASE

- **FAILURE TO CARVE OUT LATENT DEFECTS FROM THE SCOPE OF A GENERAL RELEASE BARS SUBSEQUENT CLAIMS FOR RESIDENTIAL CONSTRUCTION DEFECTS:** *Belasco v. Wells*, 234 Cal. App. 4th 409 (2015).

After settling a dispute with the defendant builder by means of a settlement agreement with a general release and waiver of known and unknown claims under section 1542 of the Civil Code, a homeowner discovered a defect in the roof, and brought an action against the builder and its surety. The defendants moved for summary judgment based on the release, and the trial court granted the motion.

On appeal, the Court affirmed the judgment. The central issue raised in the appeal was whether a latent defect could be the subject of a release under the Right to Repair Act. Under section 926 of the Civil Code, one form of resolution of disputes is the builder's repair of claimed defects, but the builder cannot obtain a release or waiver in exchange for the repair work. Instead, following the repair, the homeowner may proceed

with an action for violation of statutory standards, and/or for a claim of inadequate repairs. However, under section 929 of the Civil Code, the builder can decide not to make repairs and instead seek to resolve the dispute by means of a monetary settlement. In that event, the builder may obtain a reasonable release in exchange for a monetary settlement. The Court concluded that section 929 permitted the parties to enter into a reasonable settlement and that the settlement of the first case was reasonable because the plaintiff understood the agreement and was represented by counsel in its negotiation.

REVIEW GRANTED

- ***United Riggers & Erectors, Inc. v. Coast Iron & Steel Co.,* S231549.**

The California Supreme Court granted review in this case to resolve a split among the courts of appeal regarding the "disputes" for which retention may be withheld under California's prompt payment statutes: section 7107 of the Public Contract Code in the case of public works of improvement, and sections 8810 *et seq*. of the Civil Code in the case of private works. These statutes generally require that retention payments be made by owners to general contractors, and general contractors to subcontractors, within 45 to 60 days of completion of the project; however, in the event of a dispute, an amount not to exceed 150 percent of the disputed amount may be withheld pending resolution of the dispute.

These prompt payment statutes do not define the term "dispute" for which the continued withholding of retention is permitted. In *Martin Brothers Construction, Inc. v. Thompson Pacific Construction, Inc.*, 179 Cal. App. 4th 1401 (2009), the Court of Appeal for the Third Appellate District broadly construed the term dispute to include claims for extra work. Subsequently, in *East West Bank v. Rio School District*, 235 Cal. App. 4th 742 (2015), the Court of Appeal for the Second Appellate District disagreed with *Martin Brothers* in concluding that a dispute over the contract price does not entitle a public entity to withhold funds due a contractor, and rejected the argument that claims for extra work were disputes within the meaning of section 7107. *United Riggers* was another decision of the Court of Appeal for the Second Appellate District, and the court there chose to follow *East West Bank*.

The California Supreme Court limited review to the following issue: May a contractor withhold retention payments when there is a good faith dispute of any kind between the contractor and a subcontractor, or only when the dispute relates to the retention itself? Of note, the *Martin Brothers* decision was authored by the Chief Justice of the California Supreme Court when she was on the Court of Appeal.

- ***McMillin Albany LLC v. Superior Court*, S229762.**

The Right to Repair Act (Civil Code §§ 895 *et seq*.) was enacted in response to the California Supreme Court's decision in *Aas v. Superior Court*, 24 Cal. 4th 627 (2000), which held that construction defects in residential properties were not actionable in tort, in the absence of actual property damage. The Act establishes a statutory pre-litigation process, precludes homeowners from filing suits for construction defects prior to providing the required notice to the builder, and permits the builder to stay the litigation until the process is filed. In the *McMillin* case, homeowners claiming they had suffered property damage as a result of construction defects did not follow the pre-litigation notice process. The trial court denied a stay of the action, but the Court of Appeal reversed.

The issue before the Supreme Court is whether the Right to Repair Act precludes homeowners from bringing common law causes of action for defective conditions that resulted in physical damage to the home. It looks like a full circle back to *Aas*.

- ***Sweetwater Union School Dist. v. Gilbane Building Co.*, S233526**.

This case embodies two relatively recent trends in construction litigation. First, it has become more common for public entities, or taxpayers on behalf of public entities, to challenge contract awards and seek disgorgement of moneys paid on the basis of section 1090 of the Government Code, which prohibits public officers and employees from having any financial interest in any contract made by them in their official capacity, or by any body or board of which they are member. The school district in this case sued several contractors alleging that contracts were awarded to them because the contract provided school officials expensive dinners, tickets to entertainment and sporting events, and travel expenses, and made contributions to political campaigns and charities, in an effort to influence the officials to award defendants certain construction contracts. Second, contractors sued under these statutes, as in this case, have been filing anti-SLAPP motions based on the assertion that their conduct, at least in making political contributions, constitutes political expression and petitioning, which is protected by the First Amendment. Evidence offered in opposition to such motions often takes the form of plea agreements, related affidavits supporting the plea, and grand jury transcripts. The Supreme Court's review of this decision presents the following issues: (1) Is testimony given in a criminal case by persons who are not parties in a subsequent civil action admissible in that action to oppose a special motion to strike? (2) Is such testimony subject to the conditions in Evidence Code section 1290 *et seq*. for receiving former testimony in evidence?

STATUTES

- **PUBLIC ENTITIES MUST LIQUIDATE DAMAGES FOR DELAY**

Section 7203 of the Public Contract Code applies to public works contracts entered into on or after January 1, 2016. Section 7203(a) provides that any public work contract that "contains a clause that expressly requires a contractor to be responsible for delay damages is not enforceable unless the delay damages have been liquidated to a set amount and identified in the public works contract."

- **STANDARD LOWERED FOR CONTRACTORS SEEKING TO ESTABLISH SUBSTANTIAL COMPLIANCE WITH LICENSURE REQUIREMENTS**

Section 7031(e) of the Business & Professions Code was amended by AB 1793. AB 1793 was introduced in response to the *Judicial Council of California v. Jacobs Facilities, Inc.*, 239 Cal.App.4th 882 (2015). As introduced, AB 1793 would have amended section 7031 to permit a contractor to be paid even if the contractor was not licensed "at all times." As finally approved, AB 1793 revised the criteria for a court to find that a contractor is in substantial compliance with the licensure requirements by removing the condition that the contractor "did not know or should not have reasonably have known, that he or she was unlicensed during performance of the contract."

- **BEST VALUE PROCUREMENT EXPANDED**

Public Contract Code sections 20119 *et seq*. establishes a pilot program allowing the Los Angeles Unified School District to use best value procurement, and Public Contract Code sections 20155 *et seq*. establishes a pilot program allowing certain counties to use best value procurement.

- **SCHOOL DISTRICTS AUTHORIZED TO USE JOB ORDER CONTRACTING**

Public Contract Code sections 20919.20 *et seq*. authorize school districts statewide to use job order contracting as that term is defined in section 20919.21.