



# Legal Briefing

Winter 2002

## Mold Spreads to the California Legislature

by John O'Hara

**W**e all know by now that mold is ubiquitous and is necessary for the recycling of organic building blocks that allow plants and animals to live. Mold, however, has become ubiquitous in a new way. Effective January 1, 2002, mold spread to the California Legislature. We are not talking about the State Capitol building being infected with mold. New legislation in California gave mold a permanent place in our statutory framework.

The new legislation is just one more reason for real property owners and developers to treat mold issues seriously and intelligently. Individuals and entities that are ignoring or underestimating mold issues are suffering the consequences. Just ask Farmer's Insurance. Its mishandling of a mold claim led to a \$32 million verdict. There are many other large verdicts and settlements involving mold occurring each month.

The mold phenomenon raises several issues and concerns for developers and owners of real property. Our overall message is to stay informed and educated on developments in the mold arena. Here are a few items to consider.

### The New Legislation

Most agree that one of the major frustrations in dealing with mold claims is the lack of uniform standards or guidelines for how to determine what kinds and quantities of mold are problematic. The goal of the new legislation is to empower the Department of Health Services to develop standards by which to detect, measure and remediate mold. The problem is that even though the statute is effective as of January 1, 2002, the standards are not expected to be completed until 2003. In the interim, there will still be uncertainty regarding what mold levels are harmful, what needs to be disclosed to buyers or tenants and what is a proper remediation approach.

### Beware of Unqualified Contractors and Experts

Charlatans are everywhere in the mold arena. We strongly suggest that clients do their homework before selecting a contractor or expert to assist them in dealing with a mold issue. Some of the worst horror stories are the result of inexperienced contractors and experts causing a relatively small mold issue to mushroom (pun intended) out of control.

### Insurance Issues

Clients cannot necessarily rely on their insurance policies to cover mold claims, especially with the newer policies. Most insurers seem to be excluding mold claims in the newer policies. These new policies should be carefully negotiated and reviewed so the insured acquires the most coverage reasonably available and knows what coverage it is getting. As to the older policies, insurers are grudgingly paying claims, but often not without a fight. If a claim is presented, the insured client should be careful to raise all of its arguments for coverage under the policy to ensure that the insurer honors its obligations.

### Risk Management

In light of the potential exposure to future mold claims, it is crucial that clients review the indemnity provisions (or lack thereof) in their contracts or leases which deal with mold. The client should understand the risk being undertaken and how to properly assign this risk among the parties to the contract.

### Representations and Warranties

Clients should also be careful in providing representations and warranties as to the existence or nonexistence of mold when selling property. Conversely, when acquiring property, it is important to seek as much information and as extensive representations and warranties as can be acquired regarding the existence or nonexistence of mold.

Should you have questions regarding dealing with issues related to real estate and mold, please contact John A. O'Hara (litigation department) or Jane M. Samson (transactional department) of Newmeyer & Dillion LLP.

*John O'Hara is a litigation partner at Newmeyer & Dillion LLP with 14 years of experience representing homebuilders in construction defect, insurance and business litigation matters.*

## Additional Insureds Are Entitled to a Complete Defense

by Reed N. Archambault

**S**ome of the most frequently debated issues in California (especially in construction defect actions) are the defense and indemnity obligations of an insurer to a lender, developer or other person added to the insurance policy as an additional insured. Typically, insurers will claim that their defense obligation to the additional insured is less than that owed to the named insured or that their obligation to defend additional insureds is limited to claims of liability arising directly through the acts of the named insured.

Any doubt regarding the obligation of the insurer to immediately and fully defend its additional insured was eliminated by the California Court of Appeal in *Presley Homes, Inc. v. American States Ins. Co.* (2001) 90 Cal.App.4<sup>th</sup> 571. In this case, in which Newmeyer & Dillion represented Presley Homes, the court determined that it was not enough for an insurer to offer to pay a percentage of the additional insured's defense or to hire counsel to defend only those issues related to the named insured's services. To the contrary, the court confirmed that each insurer of the additional insured owes it an immediate and complete defense as to any and all claims asserted against the additional insured.

Having represented many leading businesses, lenders and developers, Newmeyer & Dillion LLP has years of experience and expertise at both the trial and appellate levels in securing insurance policy benefits owed to its clients by their direct and additional insurers.

*Reed N. Archambault is a litigation attorney at Newmeyer & Dillion LLP with over 11 years of insurance coverage, bad faith and business litigation experience.*



# Mandatory Owner-Supplied Security Under Construction Contracts

by Jane M. Samson

**A**n unpleasant surprise may await an owner who enters into a construction contract after January 1, 2002: the owner may be required to provide security to its general contractor to back up the owner's financial obligations under the contract and to keep the security in place until the owner has made all payments required under the construction contract. If the owner fails to comply with these requirements at any time during the contract term, the general contractor has the unilateral right to suspend work on the project until the owner provides the necessary security.

## Applicability

The new law, enacted by AB 1534, applies where:

- an owner contracts for a work of improvement, for construction, alteration, addition to, or repair of the property;
- the project is not a single-family residence (either a single residence or part of a subdivision) or associated improvements, a low income housing development eligible for density bonuses, or a public works project; and
- the value of the contract is either (a) more than \$5,000,000, if the owner is the fee title holder of the property or the lessee under a lease of at least 35 years for a legally subdivided parcel, or (b) more than \$1,000,000, if the owner has any other interest in the property.

Contracts between a general contractor and its majority owner are exempt from this law.

## Requirements

For covered contracts, the owner must provide the general contractor with security for the owner's payment obligations under the contract in an amount of 15% to 25% of the contract price (depending on how long construction is anticipated to take). The security must be given by payment bond, irrevocable letter of credit, or construction security escrow account. The escrow account method may be used only if the general contractor agrees. Publicly traded companies, and privately held companies with net worths of more than \$50 million, that satisfy certain additional requirements are permitted to provide a guaranty in lieu of the other methods. The law imposes additional restrictions on each of the methods. In addition to the security requirements, the owner must give the contractor a copy of the construction deed of trust or other document that shows the amount of any construction loan obtained by the owner.

## Impact

Unfortunately for owners, the new law expressly states that these requirements cannot be waived. Therefore, owners and general contractors will need to consider whether and to what extent the law applies to their projects, what security options are available, what the financial impact of the various options will be and what their negotiating positions should be in light of this new law. Should you have any questions regarding this new law, please contact Jane Samson of Newmeyer & Dillion LLP.

*Jane M. Samson is a transactional partner at Newmeyer & Dillion LLP with over 16 years of experience in real estate, land use and public law matters.*

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# Making Arbitration Provisions Stick

by Dwight C. Hirsh

**S**ince the California Supreme Court's decision in *Armendariz*, which held that a written arbitration agreement was unenforceable because it was procedurally and substantively unconscionable, a number of written decisions regarding the enforceability of arbitration clauses have come down from all levels of both the Federal and California State Courts. Several of these decisions have been published in the last few months. The results have been mixed. In some of these cases, the arbitration clauses have been struck down in their entirety as unconscionable. In others, the arbitration clauses have been upheld in their entirety or slightly modified by the court through the excision of unconscionable terms. In reconciling these decisions and the rationale behind them, one can determine certain guidelines to enhance the enforceability of such clauses.

## Protecting Against Unconscionability Claims

- The arbitration clause should be clear and explicit. Courts have consistently denied arbitration when the arbitration provision is buried in a large document, confusing, or not sufficiently highlighted. One technique in avoiding this argument is to provide the arbitration clause in a separately signed addendum to the contract, which is clearly labeled and printed in bold type.

- If arbitration is to be used for certain claims by one party (such as a seller of real estate) against the other (such as the buyer of real estate), the same arbitration procedures should be used for the seller's claims against the buyer, unless there is a legitimate business reason for exempting certain claims (e.g., claims for injunctive relief).

- If a party requiring that an arbitration agreement be signed has a specific justification based on certain "business realities" for using such a provision, it may be useful to explain this justification in the contract itself.

- If the arbitration clause addresses the allocation of costs, care should be taken to ensure that the party being asked to sign the arbitration agreement not be required to pay prohibitive costs.

- Although courts recognize that discovery may be limited in arbitration proceedings, such a limitation should be carefully drafted.

There are a number of other strategies which may also be used to protect the enforceability of an arbitration clause and to provide for an acceptable back-up provision (such as a judicial reference or a waiver of jury trial) should the arbitration provision not be upheld. Should you have any questions regarding these issues, please contact Gregory L. Dillion, Craig A. Callahan, or Dwight C. Hirsh of Newmeyer & Dillion LLP.

*Dwight C. Hirsh is a transactional and appellate law associate at Newmeyer & Dillion LLP with over seven years of general business, real estate and insurance law experience.*

# About Newmeyer & Dillion LLP

**N**ewmeyer & Dillion LLP, originally formed in 1984, is comprised of creative, highly motivated business attorneys who possess outstanding credentials, training and experience in their respective fields of practice. The firm represents a wide variety of clients, which include national and local financial institutions, real estate development companies, manufacturers and service organizations, as well as individuals.

Practice areas include:

- Litigation
- Lending & Finance
- Real Estate Transactions
- Business Arrangements
- Estate Planning