California Offshore Wind, the Challenges and Opportunities

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Conference Reference Materials

Statutory and Contractual Provisions to be Aware of When Entering into Offshore Wind Project Contracts in California

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In 2018, California's government enacted the 100 Percent Clean Energy Act, which requires the State to be carbon neutral by 2045.[i] As part of that effort, in 2021, California's government further enacted Assembly Bill 525, requiring multiple government agencies to work together to develop a plan for offshore wind energy developments off the California cost in federal waters.[ii] In working with the U.S. Department of the Interior's Bureau of Ocean Energy Management (BEOM), two leasing areas have been established for offshore wind projects in California. These areas are the Humboldt Wind Energy Area and the Morro Bay Wind Energy Area, which combined will have the potential to generate up to 4.6 gigawatts of renewable energy.[iii]

Most of the entities involved in these projects will be from Europe, as they have the expertise required to design and develop offshore wind projects. For non-California contractors and subcontractors, this Note provides a brief overview of some of the important statutory and contractual provisions to be aware of when negotiating and performing contracts related to California's offshore wind projects.

A Failure to Be Properly Licensed in California May Lead to Penalties, Invalid Contracts, and Disgorgement of Profits

Proper licensing in California is fundamentally important, as a failure to do so may lead to severe penalties, invalid contracts, and disgorgement of profits.

Pursuant to California's Business and Professions Code § 7000 *et seq.*, it is illegal for anyone to engage in contracting business without a license, and a violation is a crime. In California, engineering firms cannot forms LLCs in California.[iv] Licensing in California is governed by the Contractors' State License Board, and applicants generally must qualify by written examination.[v]

In addition to facing criminal liability, contractors who operate in California without a license relinquish their right to go to court to enforce their contracts, as they are unenforceable. This is true even if the president of the company, for example, holds the license.[vi] California courts have stated that "[n]o principle of law is better settled than that a party to an illegal contract cannot come into a court of law and ask to have his illegal objects carried out … The courts generally will not enforce an illegal bargain or lend their assistance to a party who seeks compensation for an illegal act."[vii] What is more, a leading California construction law treatise has warned that "[i]f a contractor has done a job on the request of the owner, has bought materials and paid workers, and has done a good job, and if the owner has accepted and retained the fruits of the contractor's labor, it would seem that the contractor should be paid, unless there is good reason for reaching a contrary result. The California Legislature has said that failure to be properly licensed at all times during performance of a job is good reason for denying compensation."[viii]

In addition to not being able to enforce a contract in court, California Business and Professions Code § 7031 states that "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." California courts have held that a corporation unlicensed as contractor was not entitled to recover profits that would have been realized under construction contract had it been permitted to perform on ground that it would have secured contractor's license had construction commenced. [ix]

Liability may also be imposed on owners for contractors who are not licensed in California. While typically a contractor acts as an independent contractor to that of an owner and is not an agent of the owner, California Labor Code § 2750.5 "establishes a rebuttable presumption that a person performing services for which a contractor's license is required is an agent, rather than an independent contractor. The presumption is said to be rebuttable because it can be overcome by proof that the person customarily engages in an independently established business and has both the right to control and discretion as to the manner of performance of work."[x] For example, "in *Foss v. Anthony Industries*, 139 Cal. App. 3d 794, 189 Cal. Rptr. 31 (4th Dist. 1983), a motorcyclist was killed by a truck that was owned by an unlicensed excavation and grading contractor (a partnership). The partnership had been employed by a swimming pool contractor to perform excavation work for a swimming pool. The court held that under Labor Code § 2750.5, the partnership was the agent of the swimming pool contractor, and therefore the swimming pool contractor was liable for the wrongful death under the doctrine of respondeat superior."

California Has Strict Prompt Payment and Prevailing Wage Laws

Contractors and subcontractors on offshore wind projects in California should also be aware of the State's prompt payment and prevailing wage laws. On both public and private works contracts, California Business and Professions Code § 7108.5 states that "[a] prime contractor or subcontractor shall pay to any subcontractor, not later than seven days after receipt of each progress payment, unless otherwise agreed to in writing, the respective amounts allowed the contractor on account of the work performed by the subcontractors, to the extent of each subcontractor's interest therein." A failure to do so "shall constitute a cause for disciplinary action and shall subject the licensee to a penalty, payable to the subcontractor, of 2 percent of the amount due per month for every month that payment is not made." The prevailing party shall be entitled to attorney's fees and costs.

In addition, for public works projects, which the Humboldt Wind Energy Area and Morro Bay Wind Energy Area offshore wind projects constitute as such, California Public Contract Code § 10262.5 provides that "the head of each state agency shall submit to the Legislature a report on the number and dollar volume of written complaints received from subcontractors and prime contractors on contracts in excess of three hundred thousand dollars ($300,000), relating to violation" of California's prompt payment laws. This has important consequences, as a violation becomes public record and could cause future project awards to come under scrutiny.

Contractors, Subcontracts, and Sub-Sub Contractors Can Attach Mechanic's Liens to Private Property in California

Onshore project owners of private property who may be facilitating the construction of the offshore windfarms in California, should be cognizant of the State's mechanic's lien laws and plan accordingly in any contracts that it enters into. A mechanic's lien is a claim against real property, which may be filed if a claimant has provided labor or furnished materials for the property and has

not been paid.[xi] In California, a mechanic's lien derives from the State's Constitution and "courts have uniformly classified the mechanics' lien laws as remedial legislation, to be liberally construed for the protection of laborers and materialmen."[xii] Without proper planning, project owners (i.e., employers) from outside California who are not knowledgeable about the extent of a mechanic's lien in California may be surprised to find that general contractors (i.e., main contractors), subcontractors, and sub-subcontractors have the right to place a mechanic's lien on private property.

For offshore windfarm developers, mechanic's liens cannot be attached to either State or Federal property.[xiii] Given that the U.S. government owns the property where the Humboldt Wind Energy Area and Morro Bay Wind Energy Area's offshore floating windfarms will be located, mechanic's liens cannot attach to public property.

Dispute Resolution Clauses Requiring Arbitration or Litigation of Construction Contracts Outside of California Are Void

Any dispute resolution clauses, including litigation or arbitration provisions, must provide California as the seat or venue to resolve those disputes. This is because California Civil Procedure Code § 410.42 states that any provision requiring litigation, arbitration, or otherwise "between the contractor and a subcontractor with principal offices in [California], for the construction of a public or private work of improvement in this state, shall be void and unenforceable." This also includes any provision "which purports to preclude a party from commencing such a proceeding or obtaining a judgment or other resolution in [California] or the courts of [California]." California Civil Procedure Code § 410.42 has also been applied by California state courts to hold a contract provision requiring mediation in another state to be void.[xiv]

In addition, it is recommended owners provide that any dispute resolution clause in their agreement include an obligation that the clause equally apply and be incorporated in any downstream contracts entered into for work or materials on the project. All such dispute resolution clauses should require that contractors and subcontractors agree to be joined in any dispute proceedings. This is for two important reasons. First, to the extent mechanic's liens may apply, it is important that those liens be resolved in one proceeding, especially if the owner is involved. Second, it is more cost effective and efficient for any dispute involving upstream and downstream contractors to be resolved in one proceeding.

Provisions Indemnifying Sole Negligence or Willful Misconduct Are Void

In addressing indemnity provisions, California state courts have divided indemnity clauses into three types.[xv] "Type I provides expressly and unequivocally that the indemnitor is to indemnify for the negligence of the indemnitee. Type II provides that the indemnitee is indemnified against its own acts of passive negligence but not against its own acts of active negligence. Type III provides indemnity for damages caused by the indemnitor but does not provide indemnity for damages caused by anyone else. The court determined that an indemnity clause for damages "growing out of the execution of the work" did not evidence a specific intent that a non-negligent subcontractor would be obliged to provide indemnity to the prime contractor. To obtain greater indemnity, specific language must be used.

A court has explained that a Type I agreement provides unequivocally that the indemnitor will provide indemnity against claims caused by the negligence of the indemnitee. A Type II clause provides indemnity for the passive negligence of the indemnitee but not for active negligence. Under a Type III clause there is no obligation to indemnify against claims caused by the indemnitee. Under a Type III clause, any negligence of the indemnitee, active or passive, will bar indemnity."[xvi]

In construction contracts, California Civil Code § 2782 voids (with limited exceptions) any contract provisions that "purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants, or independent contractors who are directly responsible to the promisee, or for defects in design furnished by those persons." Moreover, § 2782 voids any contract provisions with a public agency or the owner of private property that "purport to impose on the contractor, or relieve the public agency from, liability for the active negligence of the public agency."

Pay-if-Paid Provisions Are Unenforceable, While Certain Pay-When-Paid Provisions May Be Unenforceable

"A pay-if-paid clause is one that makes it clear that a prime contractor's receipt of payment from the owner is a condition precedent to its obligation to make a payment to a subcontractor,"[xvii] while a pay-when-paid clause "fixes a time for compensation."

California's Supreme Court has held that pay-if-paid are unenforceable, as established by *Wm. R. Clarke Corp. v. Safeco Ins. Co*.[xviii] However, the California Supreme Court has not addressed whether pay-when-paid clauses are strictly unenforceable.[xix] The case law indicates that such clauses may be enforceable, but only for a reasonable time. For example, in *Crosno Construction, Inc.*, the California Court of Appeal considered whether a pay-when-paid provision in a subcontract precluded the subcontractor from recovering under a payment bond while the general contractor's lawsuit against a project owner remained pending. The court concluded that the provision was unenforceable because it unreasonably forestalled accrual of the subcontractor's payment bond rights for an indefinite period of time while the general contractor pursued litigation against the project owner. The court reasoned that enforcing the pay-when-paid provision would have postponed the subcontractor's right to recover under the payment bond for an indefinite time period until the contractor's litigation against the project owner concluded. Such a result would have unreasonably affected or impaired the subcontractor's statutory payment bond remedy under California Civil Code § 8122.

Therefore, while it is currently unclear what constitutes an unreasonable time in the context of a pay-when-paid provision, it is likely that such a clause would be unenforceable when it affects or impairs rights of a contractor or subcontractor, for example a right to statutory payment bond remedies or imposing mechanic's liens.

The U.S. Federal Jones Act Creates Issues, But Steps Are Being Made to Resolve Them

In addition to the issues contractors should be aware of on offshore wind projects in California, the Merchant Marine Act of 1920, better known as the Jones Act, is also very important.

The Jones Act requires vessels going points in the U.S. and transporting passengers or merchandise to be a U.S.-flagged vessel. More specifically, in order to not be in violation of the Jones Act the vessel must (1) be built in the United States (and have never been rebuilt abroad); (2) be owned and controlled by citizens of the United States; (3) have primarily a U.S. citizen crew and (4) have a Certificate of Documentation with a coastwise endorsement issued by the U.S. Coast Guard.

In January 2021, the U.S. affirmed that the Jones Act applies to non-mineral energy projects, such as offshore wind projects. Shortly thereafter, the U.S. Customs and Border Protection, which is responsible for issuing rules related to the Jones Act, confirmed that the Jones Act "extends U.S. law to the physical subsoil and seabed of the [Outer Continental Shelf], as well as installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exploring for, developing, or producing resources, including non-mineral energy resources."[xx]

Given that the vast majority of vessels used for offshore wind projects are non-U.S.-flagged vessels, it is not quite clear yet how the many U.S. offshore wind projects will be developed, and this is true of California. However, steps are being made to resolve this issue. It was recently reported that the first Jones Act-compliant installation vessel should be completed by the end of 2023.[xxi] In addition, during a Law and Policy Roundtable regarding offshore wind energy coming to California, held at Musick Peeler, the panel informed the audience that California stakeholders and government are currently exploring the development of ports in the State that will have the infrastructure to build vessels for use in offshore wind projects. The panel also let the audience know that local communities, such as those in Humboldt County appear to be receptive of the idea, as it will attract many jobs for the local community.

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[i] https://www.energy.ca.gov/sb100
[ii] https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220AB525
[iii] https://www.energy.ca.gov/programs-and-topics/topics/renewable-energy/offshore-renewable-energy
[iv] California's Business and Professions Code section 6738 "does not prohibit one or more civil, electrical, or mechanical engineers from practicing or offering to practice … as a sole proprietorship, partnership, limited liability partnership, firm, or corporation." The Code is silent as to LLCs.
[v] § 4:1. Necessity of license, Cal. Constr. L. Manual § 4:1
[vi] In Opp v. St. Paul Fire & Marine Ins. Co., 154 Cal. App. 4th 71, 64 Cal. Rptr. 3d 260 (5th Dist. 2007),
[vii] Yoo v. Jho, 147 Cal. App. 4th 1249, 55 Cal. Rptr. 3d 243 (2d Dist. 2007) (internal citations omitted) (internal quotation marks omitted).
[viii] § 4:39. Compensation denied to unlicensed contractors, Cal. Constr. L. Manual § 4:39
[ix] Brunzell Constr. Co. v. Barton Development Co. (Cal. App. 1st Dist. 1966), 240 Cal. App. 2d 442, 49 Cal. Rptr. 667, 1966 Cal. App. LEXIS 1366.
[x] § 4:62. Owner's liability for acts of unlicensed contractor, Cal. Constr. L. Manual § 4:62
[xi] (Kim v. JF Enterprises (1996) 42 Cal.App.4th 849, 854 [50 Cal. Rptr. 2d 141].)
[xii] Brewer Corp. v. Point Ctr. Fin., Inc., 223 Cal. App. 4th 831, 839, 167 Cal. Rptr. 3d 555, 560 (2014)
[xiii] N. Bay Constr., Inc. v. City of Petaluma, 143 Cal. App. 4th 552, 557, 49 Cal. Rptr. 3d 455, 457-58 (2006)
[xiv] Templeton Development Corp. v. Superior Court, 144 Cal. App. 4th 1073, 51 Cal. Rptr. 3d 19 (3d Dist. 2006)
[xv] MacDonald & Kruse, Inc. v. San Jose Steel Co., 29 Cal. App. 3d 413 (2d Dist. 1972).
[xvi] § 1:102. Type III clause, Cal. Constr. L. Manual § 1:102
[xvii] § 1:36. Pay-if-paid clause, Cal. Constr. L. Manual § 1:36
[xviii] Wm. R. Clarke Corp. v. Safeco Ins. Co., 15 Cal. 4th 882, 64 Cal. Rptr. 2d 578, 938 P.2d 372 (1997).
[xix] Crosno Constr., Inc. v. Travelers Cas. & Sur. Co. of Am., 47 Cal. App. 5th 940, 940, 261 Cal. Rptr. 3d 317, 319 (2020)
[xx] (HQ H309168)

[xxi] https://www.projectcargojournal.com/offshore/2023/02/24/first-jones-act-compliant-vessel-almost-complete/?gdpr=deny