

ProNetwork News

Risk Management Tools for the Design Professional

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Shootout At The Copyright Corral

By Brian K. Stewart and Clay R. Wilkinson, Esqs.

Copyright: The Unused Weapon

It is no secret that in the current economic environment, it can be difficult to find projects, and the problem may not end there. It can be even more difficult to secure prompt payment from your client. Sometimes, it is difficult to secure payment *at all*.

There are certain statutory protections for architects in many states: design professionals' liens for certain projects and mechanics' liens for others. But like other legal remedies, statutory protections require timely legal action, and the legal fight can be both financially and personally arduous.

Most of the time, architects and other design professionals have one potential weapon in their arsenals that no one else on the project can bring to the unpaid fees fight: the ability to control the use of their work product through copyright protection. As long as the work product meets certain statutory requirements and their rights are not otherwise waived, design professionals own a copyright by authorship alone. Additionally, registering the copyright with the U.S. Copyright Office (<http://www.copyright.gov>) entitles the copyright owner to additional statutory damages and attorneys' fees in any ensuing infringement action.

Copyright is an underutilized tactic in the fee collection "gun fight." On a project where construction had been in full progress but is stalled because no one – design professionals, project manager, general, and subcontractors – has been paid by the owner, the standard litigation tactic is to sue for breach of contract and file an action for foreclosure on any lien rights. But what if the owner is also in default on its construction loan?

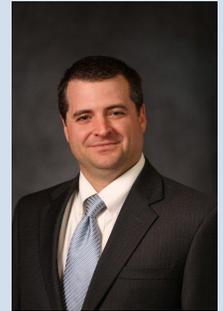
The original lender typically has priority over most if not all lien claimants. Further compounding matters in the current economy is the fact that many projects are "upside down" (the property is worth substantially less than the lien value). The construction lender, with a lien of greater value than the *aggregate* mechanics' lien value, has every incentive to fight to the death to assert its lien priority and commits itself to a war of attrition against all the other lien claimants.

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Frequently, the owner is a single-asset Limited Liability Company (LLC) or similar legal entity. If such an owner becomes insolvent, and all it owns is the over-leveraged single asset, the contract is worthless: a recovery on paper is not worth the paper it is printed on. If the lender has priority, its foreclosure will often wipe out all the mechanics' lienors. While it may not be the cure-all in every circumstance, copyright can set design professionals apart from other players in the project and create the appropriate leverage to get you paid.

A Real Gunfight

Our office represented the architect on a major condominium conversion project near downtown Los Angeles. The single-asset LLC owner acquired the property, hired our client, then hired a general contractor to begin work on the project. After work had begun, the owner obtained construction financing to the tune of \$19.5 million. That was 2007. Everyone knows what happened next.

Times got tough for the Owner, and everyone working on the project. By 2009, the Owner had stopped paying many of the project team members, including the architect, but work still continued at a snail's pace. The Owner was in default on its \$19,500,000.00 note. The construction lender failed in 2009, was taken over by the FDIC, and had its assets assigned to another major bank. By 2010, it had initiated judicial and power of sale foreclosure proceedings on the property. Mechanics' liens were recorded, complaints and cross-complaints filed – our client included. The “gunfight” had begun.

Most of the parties to the mechanics' lien actions were subcontractors who had not been paid in months. Amounts due and owing, while significant to their livelihoods, amounted to little in the world of lenders on major real estate development projects. The general contractor had a seven-figure claim. Our client's claim was in the six figures.

The lender was represented by a title insurance company whose tactic was to litigate the mechanics' lien claims fiercely so that the small players would give up and drop out. It became a war of attrition as to the small players. The title insurance company then proceeded to dust off every ancient principle in equity and mortgage law, along with every nuance in the highly technical area of mechanics' liens, and bring them to bear on the remaining parties. Mechanics' lien in California law doesn't care if you're a design professional or a contractor when it comes to lien priority.

Additionally, the lender had two secret weapons of its own: (1) it acquired the note and deed of trust on the property for next to nothing despite its stated and recorded substantial value; and (2) it had an investor that specializes in urban revitalization waiting in the wings to buy the note and finish the project.

The result was a protracted and very expensive lawsuit – still ongoing – in which the general contractor and subcontractors will go to battle/trial on the issue of whose lien has priority.

Not so for the architect. *Why?*

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The Architect's Secret Weapon

The lender sold the note to the investor just before the last day to notice foreclosure on the property by power of sale. The lender owned a debt for which it never loaned anything, so whatever it took from the investor was "found" money. The investor was able to buy the property at a discount, foreclose to attempt to wipe out the mechanics' liens, and purchase the project at its own auction because it could credit bid up to \$19.5 million dollars. The investor now owned that debt, even though it probably paid 30 cents on the dollar for it.

But the investor, who needed a finished project to capitalize on the investment, couldn't finish the project because our client retained its copyright.

In its contract, a modified Standard AIA B151 - 1997, the architect had a provision that granted a license to the owner to use its work product for the project. However, the contract was *terminable for non-payment of fees*. By terminating the contract, the architect could also terminate the license to use the plans. Without a license to use the architect's work product, the project was in peril of failure because of the threat that copyright infringement litigation could derail the whole investment plan!

Not only did the investor seek to settle with the architect upon receipt of a cease and desist letter prepared by our office – *it actually hired the architect to finish the construction administration and closeout of the project.*

Almost a year later, the other mechanics' lienors are still embroiled in litigation; waiting to get paid and paying attorneys' fees, expert fees, and court costs. The architect collected about 90% of his past fees and in this difficult market, obtained a contract on favorable terms to handle the architectural work going forward.

Don't Bring a Knife to a Gun Fight

Damages for breach of contract and liens are the primary legal remedies available to collect unpaid fees. Unfortunately for design professionals, these remedies do not always create the leverage necessary to ensure payment. Savvy construction lenders and investors know that there's no special treatment for design professionals under the lien laws, and they can exploit that by treating design professionals like they would the plumbing or carpet subcontractor.

A design professional who has retained ownership of copyright has potentially "game-changing" leverage that parties to the typical construction project do not. In our client's case, we brought the proverbial "gun to the knife fight"!

To learn how to better utilize copyright to ensure payment of your fees, please contact an attorney with experience in the field: put a gunslinger on your side when facing a fee fight.

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Moore Insurance Services offers many professional liability and property & casualty insurance programs. Many of these programs are endorsed or commended by the professional associations and organizations that we support including: The American Institute of Architects (AIA), National Society of Professional Engineers (NSPE), American Council of Engineering Companies (ACEC), Michigan Association of Environmental Professionals (MAEP) and Michigan Society of Professional Surveyors (MSPS).

