CLM 2016 New York Conference
December 1, 2016
New York, NY

Increased Use of Drone Technology in the Construction Industry and its Affect on Insurance and on Claims

I. Use of Drones and Similar Technology

The government and some private firms are using drones for matters such as: border patrol, environmental monitoring, research; and specific tasks such as aerial shots for movies, surveys, etc. Current technology can attach to the drones digital cameras and video (which can be used for example, by police force to take images of collision scenes and vehicles), Inertial Measurement Units that measure and report the drone's velocity, orientation, and gravitational forces, and LiDAR, which can measure distance by illuminating a target with a laser and analyzing the reflected light. Other uses include potential delivery of packages other activities. While this presentation discusses drones as an example to a newer developed technology that has become more popular with private companies, there is a lot of technology which is newer and which we do not know what are the potential risks from its use.

The legislation of the use of drones is on-going and is also subject to comment and review by the public. Those who wish to currently operate a drone commercially, need to obtain FAA approval and can petition the FAA for exemption from requirements to prove the drone's safety (size, location, purpose). It is not yet clear how enforcement of such rules occurs.

From a privacy standpoint, a Presidential Memorandum has been issued that requires federal agencies to ensure that policies and restrictions protect the public against the potential abusive interference of privacy.

II. Use of Drones in Construction Projects

Drones can/are used in many construction related projects, for example:

- They are used by surveyors for mapping.
- They are used by civil and structural engineers for inspecting inaccessible areas such as dams.

● They are be used by electrical engineers to inspect solar panels and electrical grids.

● They are used by contractors supervising a construction project that spans over many miles or anywhere from high rises to deep excavations.

● They are used by landscape architects, agronomists and arborists trying to determine how a crop is growing, responding to a particular chemical fertilizer or was affected by fire or other natural disasters.

There is no limit to how drones can be used.

III. Liability Considerations

A. Who Operates the Drone

The contractors and design professionals operating the drones can be subject to liability for error and omission in improperly operating a drone and causing property damage or physical injury or, they may be liable for hiring a third party to operate the drone.

B. Respondeat/Superior

Assuming the drone incident is caused by a drone operator, the question will be whether the construction professional will be liable for an independent contractor he/she retained. California Civil Code Section 2338 holds for example, that a principal responsible to third persons for negligence of his agent "in the transaction of the business of the agency,..." Was the drone operator an agent of the construction professional? Even an employer is not automatically liable for an act committed by its employee. "Respondent superior liability is not synonymous with strict liability. The employer is not liable for every act of the employee committed during working hours." *Bailey v. Filco, Inc.* (1996) 48 Cal. App. 4th 1552, 1560. Moreover, a construction professional can claim that the drone operator action was intentional and as such was an intervening cause.

C. Interference with Privacy

A claim from a drone injury can be made by the ultimate client (the property owner) that the drone mistake caused damages to the construction, or it can be made by a third party being injured by the flight of the drones. A third party claim can be for personal or property damage, which is easy to analyze. However, it can also be for invasion of privacy.

There are "four distinct kinds of activities violating the privacy protection and giving rise to tort liability: (1) intrusion into private matters; (2) public disclosure of private facts; (3) publicity placing a person in a false light; and (4) misappropriation of a person's name or likeness … Restatement Second of Torts in sections 652A-652E." *Hill v. National Collegiate Athletic Assn.* (1994) 7 Cal.4th 1, 24. The tort of intrusion "encompasses unconsented-to physical intrusion into the home, hospital room or other place the privacy of which is legally recognized, as well as unwarranted sensory

intrusions such as eavesdropping, wiretapping, and visual or photographic spying." *Shulman v. Group W Productions, Inc.* (1998) 18 Cal.4th 200, 230. The element of intrusion "is not met when the plaintiff has merely been observed, or even photographed or recorded, in a public place. Rather, 'the plaintiff must show the defendant penetrated some zone of physical or sensory privacy surrounding, or obtained unwanted access to data about, the plaintiff." *Sanders v. American Broadcasting Co.* (1999) 20 Cal.4th 907, 914—915. Accordingly, if the drone invasion is over private land then an invasion of privacy may be claimed, but the analysis will depend on whether there was some disclosure. If no photographs were taken and the drone simply flew over someone's home it may not be enough for invasion of privacy. It may simply be trespass.

D. Trespass

"Trespass is an unlawful interference with possession of property. The emission of sound waves which cause actual physical damage to property constitutes a trespass. Liability for trespass may be imposed for conduct which is intentional, reckless, negligent or the result of an extra- hazardous activity." *Staples v. Hoefke* (1987) 189 Cal.App.3d 1397, 1406. "As a general rule, landowners and tenants have a right to exclude persons from trespassing on private property; the right to exclude persons is a fundamental aspect of private property ownership." *Allred v. Harris* (1993) 14 Cal.App.4th 1386, 1390.

While a drone intrusion does not seem significant, "the general rule is simply that damages may be recovered for annoyance and distress, including mental anguish, proximately caused by a trespass." *Armitage v. Decker* (1990) 218 Cal.App.3d 887, 905.

E. Negligent Per Se

Negligent per se occurs when there is a violation of law and the violation is a substantial factor in leading to the injury. *Nunneley v. Edgar Hotel* (1950) 36 Cal.2d 493, 500–501. A plaintiff can claim that the drone operator violated various FAA regulations. There is no precedent to this issue, but a comparison can be made to real estate brokers and attorneys who violate ethical rules and regulations. In those situations courts have said that they do not give rise to a civil claim.

In connection with attorneys, "there is no independent cause of action for the breach of a disciplinary rule. (*Mirabito v. Liccardo* (1992) 4 Cal. App. 4th 41, 45-46, [5 Cal. Rptr. 2d 571].) While the rules may provide standards of conduct for attorneys, they do not alone support a claim for damages. . .[[T]he Rules of Professional Conduct 'were promulgated by the members of the State Bar primarily as ethical guidelines for its members . . . intended to operate as a shield to protect the public from unethical conduct by attorneys but not as a sword to be used to recover money damages . . . .' *Ross v. Creel Printing & Publishing Co., Inc*. (2002) 100 Cal. App. 4th 736, 746-47.

F. Nuisance

California Civil Code section 3479 provides: "Anything which is injurious to health, including, but not limited to, the illegal sale of controlled substances, or is indecent or offensive to the senses, or an obstruction to the free use of property, so as to interfere with the comfortable enjoyment of life or property, or unlawfully obstructs the free passage or use, in the customary manner, of any navigable lake, or river, bay, stream, canal, or basin, or any public park, square, street, or highway, is a nuisance." "In distinction to trespass, liability for nuisance does not require proof of damage to the plaintiff's property; proof of interference with the plaintiff's use and enjoyment of that property is sufficient." *San Diego Gas & Electric Co. v. Superior Court* (1996) 13 Cal.4th 893, 937. California's definition of trespass is considerably narrower than its definition of nuisance. "A trespass is an invasion of the interest in the exclusive possession of land, as by entry upon it … A nuisance is an interference with the interest in the private use and enjoyment of the land and does not require interference with the possession." ' California has adhered firmly to the view that '[t]he cause of action for trespass is designed to protect possessory—not necessarily ownership—interests in land from unlawful interference." *Capogeannis v. Superior Court* (1993) 12 Cal.App.4th 668, 674.)

"[T]he essence of a private nuisance is its interference with the use and enjoyment of land. The activity in issue must 'disturb or prevent the comfortable enjoyment of property,' such as smoke from an asphalt mixing plant, noise and odors from the operation of a refreshment stand, or the noise and vibration of machinery." *Oliver v. AT&T Wireless Services* (1999) 76 Cal.App.4th 521, 534. "Unlike public nuisance, which is an interference with the rights of the community at large, private nuisance is a civil wrong based on disturbance of rights in land. *Koll-Irvine Center Property Owners Assn. v. County of Orange* (1994) 24 Cal.App.4th 1036, 1041.

When a drone flies over someone's home there can be a claim for nuisance. When a drone flies over someone in a public area there is no expectation of privacy and there is no interference to land.

As to damages, they have to be significant and an appreciable invasion of the plaintiff's interests and an invasion that is definitely offensive, seriously annoying or intolerable. If normal persons in that locality would not be substantially annoyed or disturbed by the situation, then the invasion is not a significant one, even though the idiosyncrasies of the particular plaintiff may make it unendurable to him. *San Diego Gas & Electric Co., supra,* 13 Cal.4th at p. 938. Moreover, the interference with the protected interest must not only be substantial, but it must also be unreasonable, i.e., it must be of such a nature, duration or amount as to constitute unreasonable interference with the use and enjoyment of the land. The question is, whether the invasion is unreasonable is whether the gravity of the harm outweighs the social utility of the defendant's conduct.

The more drones become the norm the less they would be considered unreasonable and since their flight is usually short, they may not even be considered offensive.

IV. Shifting Liability: Preliminary Consideration

A. No Duty to Third Party

Does the drone operator owe the public a duty of safety? To what extent? The cases of duties owed to third parties are all over (depending on the industry and the State). An argument for lack of duty can be raised by showing other precedents for authority. Many cases in many different contexts found no duty owed to third parties (attorneys for example do not typically owe a duty to third parties), even when the professional could expect that its report (appraisal, audit) would be reviewed by others. Yet there is negative authority as well.

In regards to attorneys, they may be liable to non-clients only under exceptional circumstances, such as where a non-client was the intended beneficiary of the attorney's services or where harm to a non-client from the attorney's professional negligence was particularly foreseeable. *St. Paul Title Co. v. Meier* (1986) 181 Cal.App.3d 948, 950. The factors considered include: (a) the extent to which the transaction was intended to affect the plaintiff; (b) the foreseeability of the harm to the plaintiff; (c) the degree of certainty that the plaintiff suffered injury; (d) the closeness of the connection between the defendant's conduct and the injury suffered; (e) the "moral blame" attached to the defendant's conduct; and (f) the policy of preventing future harm. *Biakanja v. Irving* (1958) 49 Cal.2d 647, 650. Other factors include: (a) the likelihood that imposition of liability may interfere with the attorney's ethical duties to his or her client *Goodman v. Kennedy* (1976) 18 C2d 335, 344; and (b) the burden that extending liability would place on the professional. Some of those considerations can be argued in a case defending a construction professionals.

In regards to cases involving audits, in *F&D Co. of Md. v. Kramer & Assoc*., 2014 WL 2557921 (D.Kan.) the court found that surety adequately alleged third party claim against auditor of contractor, applying Kansas law and privity statute. Yet in *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 370, 406 the Supreme Court of California used the *Biakanja* Court duty factors to suppliers of commercial information and declared, “[W]e hold that an auditor’s liability for general negligence in the conduct of an audit of its client[’s] financial statements is confined to the client, i.e., the person who contracts for or engages the audit services. Other persons may not recover on a pure negligence theory.” Even “specifically intended beneficiaries of the audit report who are known to the auditor and for whose benefit it renders the audit report. . . may not recover on a general negligence theory.” *Id.* at 407. The Court expressly rejected liability based on mere foreseeability of reliance, declaring, “Foreseeability is not a substitute for legal duty.” *Id.* at 412. Even though the defendant should have anticipated that the misinformation might reach others, he is not liable to them." *Id.* at 408.

In *Tucker v. Ernst & Young*, 2014 WL 2619860 S.W.3d (Ala. 2014) the company earnings falsely inflated by $2.6 billion. Numerous officers, directors, employees were convicted of federal crimes for their role in fraud. Auditors were sued by shareholders in a derivative lawsuit. Based on Alabama rules of in pari delicto and comparative fault, the

knowledge of the fraud by the company's officers, directors and employees was imputed to the company and therefore barred the claim by the shareholders.

In re MF Global Holdings Ltd Investment Lit, 2014 WL. 667481 (S.D.N.Y.) customers, as assignee of trustee for company brought claims against PWC based on negligence and breach of fiduciary duty claiming they stood in the shoes of company and claimed auditor failed to detect and prevent fraudulent transfer of segregated and secured customer funds. Negligence claims were dismissed for lack of privity. In *Hecht v. Andover Assocs. Mgmt. Corp*., 114 A.D. 3d 638 (N.Y. App. Div. Feb. 5, 2014), the court held that individual member of LLC had standing to bring derivative action for professional negligence on LLC's behalf, against independent auditor for services provided to LLC. Also in *St. Malachy Roman Catholic Congregation of Genesco v. Ingram*, 841 N.W.2d 338 (Iowa Dec. 27, 2013) the court found that a financial advisor can be sued by identified beneficiaries of the individual's signed written estate plan when, due to the advisor's allegedly negligent performance of his duties, those beneficiaries do not receive what they were supposed to get under the plan.

With respect to real estate professionals there are also some relating cases. The California case of *Norman J. Krug v. Praszker* (1990) 220 Cal.App.3d 35; (1994) 22 Cal.App.4th 1814 found a continuing obligation to a third party private lender after the transaction had concluded, to warn lender of known facts relating to impairment of lender security. However, *FSR Brokerage v. Superior Court* (1995) 35 Cal.App.4th 69 found that there was no duty owed to guests injured at party when defective deck collapsed. *Coldwell Banker Residential Brokerage Co. (Salazar) v. Superior Court* (2004) 117 Cal.App.4th 158 similarly found no duty owed to children of buyer for mold related injury.

With respect to property appraisers, California courts of appeal are split as to whether an appraiser may be liable for negligent misrepresentation where the plaintiff is a third party. In *Christiansen v. Roddy*, 186 Cal. App. 3d 780 (Cal. App. 5th Dist. 1986) the court found no evidence to show that appraiser knew investors would rely on his appraisal of the property. In *Soderberg v. McKinney*, 44 Cal. App. 4th 1760 (Cal. App. 2d Dist. 1996) plaintiff trustee relied on appraiser's valuation in deciding to invest in property through a mortgage broker. The borrower defaulted and plaintiff was forced to foreclose, but there was evidence that defendant knew that a group of potential investors would rely on his report.

While a drone operator may not be able to limit claims by third parties (a drone can be more like a vehicle operator who owes a duty to the public), the construction professional is one step removed. The operator can use warning and disclaimers at the project site or with neighbors and therefore has a more direct relationship.

B. Contractual Issues

The claim by a third party injured from a drone will not be limited by contract

since the likelihood is that the drone operator was not aware of the person. However, the drone operator may have a claim for indemnity from another entity on the project and so will the construction professional.

Indemnity agreements are referred to as "specific" or "general." "Specific" are actually broader than "general" indemnity provisions. To analyze an indemnity agreement, one must look at the indemnitor, the indemnitee, what triggers the action causing the obligation to indemnify, and the scope of claims or damages from which there is indemnity.

There can be active or passive negligence that triggers the indemnity. Passive negligence is mere non-feasance. Non-feasance may be vicarious liability, failure to discover a dangerous condition, or failure to provide a duty imposed by law (for example, failing to provide a safe working environment.) Active negligence requires an affirmative act which falls below the standard of care, i.e. breach of a duty. *Maryland Casualty Co. v. Bailey & Sons, Inc.* 35 Cal.App.4th 856 (1995) held that strict liability of developer does not equate to "active" negligence.

In the past courts have found 3 types of indemnity agreements, type 1, type 2 and type 3. Type 1 is the most broad while type 3 is the most limited. Type 1 indemnity agreement example would be "subcontractor agrees to indemnify contractor from any and all claims, liability, and damages, except those arising from the sole negligence or willful misconduct of contractor." Type 2 is slightly less restrictive. It typically looks like: "subcontractor agrees to indemnify contractor from any and all claims, liability and damages arising from the performance of services." It would cover the general contractors "passive negligence." Type 3 is the most limited. This provision typically uses the following language: "subcontractor agrees to indemnify contractor from any and all claims, liability and damages caused by subcontractor's negligent acts, errors or omissions."

Courts analyzing these provisions typically look at the express language. If it does not specifically state that something will be indemnified, then the court will assume it is not being indemnified. Indemnity provisions are to be strictly construed against the indemnitee. *Rossmoor Sanitation, Inc. v. Pylon* 13 Cal.3d 622. *California Civil Code* §2778 provides that the indemnitee defend the indemnitor after a demand is made upon the indemnitor, and that any judgment against the indemnitee is conclusive on the indemnitor if the indemnitor failed to defend. In view thereof, if the subcontractor refuses to accept the defense pursuant to an indemnity agreement, it assumes the risk of any judgment imposed against the indemnitee, if it is found that indemnification was owing.

California Civil Code §§2782-2784 contains certain limitations on indemnity in construction contracts. For example, section 2782(a) states that there can be no indemnity for the sole negligence or willful misconduct of the indemnitee, indemnitee's agents, servants or independent contractors who are directly responsible to such

indemnitee, or for defects in design furnished by designers. Section 2872(b) prohibits an express indemnity of a public agency for the public agency's active negligence.

The question that may arise in connection with indemnity contracts is, whether they will be broad enough to include drones (will a surveyor agreeing to indemnity an owner hiring an independent drone operator be responsible for that operator if the contractor is sued?) And if there is an agreement as to how to deal with drones, will that be considered part of the construction project and subject to various indemnity limitations in the construction agreements?

In order to best defend oneself a design or construction professional using drones should attempt to shift the liability to an owner who is benefitting from the use and to the drone operator, if it is an independent third company.

C. Equitable Indemnity

Equitable indemnity arises without a written agreement. It requires joint and several liability which gives rise to comparative indemnity based on comparative fault. A jointly liable defendant typically joins all other jointly liable defendants by way of indemnity cross-complaint, which results in "shotgun" indemnity cross-complaints. When a claim based on drone injury is made the party sued can blame others: the drone operator, the owner of the premises etc.

V. <u>What Type of Insurance Will be Triggered to Defend a Drones Claim?</u>

A. CGL

In the context of a CGL policy it is interesting to compare how CGL policies may react to a drone claim (perhaps a claim for invasion of privacy) to how they have been struggling with cyber attack claims. The reason is, that such injuries (such as a privacy injury) were not originally intended to be covered by such policies.

In *Retail Ventures, Inc. v. Nat'l Union Fire Insurance Co. of Pittsburgh*, 691 F.3d 821 (6th Cir. 2012) hackers used local wireless network at a DSW store to get unauthorized access to a computer system, download credit card and checking account information to 1.4 million customers, and make fraudulent transactions. Plaintiffs incurred expenses for customer communications, public relations, claims and lawsuits, and attorney fees. Under a computer fraud rider to a "Blanket Crime Policy" providing payment for "Loss which the Insured shall sustain resulting directly from … [t]he theft of any Insured property by Computer Fraud," the Sixth Circuit held that a proximate cause standard applied to determine whether the insureds' suffered losses "result[ed] directly from" the computer fraud, and under that standard the insureds sustained losses "resulting directly from" the computer fraud. The insureds did not need to show that the losses resulted "solely" or "immediately" from the theft itself. The court also concluded that an exclusion barring coverage for loss of "proprietary information" did not apply because

the data (credit card and checking account information) did not fall within the plain meaning of "proprietary information."

In *Zurich adv. Sony NY* hackers accessed personal data for more than 100 million users of Sony's online video games. Sony admitted that some 12.3 million credit card numbers could have been obtained during the hacking. Sony also said that hacking results affected its operating profit by $178 million that year including costs for boosting security measures. This did not include potential compensation. 55 purported class-action complaints had been filed in the United States against Sony. Sony tendered the defense to its carriers who include AIG, ACE and Zurich. Zurich had a CGL policy written for Sony Computer Entertainment of America. Zurich claimed that it did not have any obligation to defend any other Sony units under that primary policy, since it only applies to the specific business in question. In addition, Zurich argued that its policy only covered the Sony unit for "bodily injury, property damage or personal and advertising injury." It said no such claims have been made in any of the class-action lawsuits. Even if such claims had been made, Zurich said, the policy had exclusions in place that would deny Sony coverage for the claims made.

The CGL defenses were further discussed in connection with the class action lawsuit against Dropbox claiming that its members were able to gain access to other users' data. While many courts have found liability coverage under the "personal injury" section of CGL policies – at least in cases where the policies in question had not yet been endorsed specifically to exclude coverage for cyber liability matters — obviously CGL policies are a poor vehicle for covering cyber liability breaches and may equally be a poor vehicle for covering drone claims, especially when the claim pertains to privacy violation or an administrative claim by the FAA. The definition of covered "personal injury" in a CGL policy generally includes invasions of privacy, yet there are sometimes disputes over whether there has been sufficient "publication" or disclosure of personal information to trigger the coverage. However, insurers may not have been thinking about these types of claims when they drafted their policies.

Lastly, there could be other limitations in CGL policies. For example, limitations that pertain to professional services. Is hiring a drone operator part of a professional service and is a drone operator performing a professional services? Or limitation relating to damages. If the claim is for invasion of privacy and the damages are emotional distress, will they be covered? Lastly, a claim may involve an administrative complaint or other governmental enforcements. Will violation of FAA rules and related penalties be covered? Will the defendant be able to obtain a defense to defending an administrative claim for violation of various flying rules? In connection with legal malpractice policies and policies for physicians and real estate brokers, there are often endorsements for administrative claims however, this is a new area and the endorsements have to be specific.

B. E&O

A professional would typically obtain an error and omission policy so the question will be if a contractor is sued, whether flying a drone is considered a professional service. If it is, and the contactor will not have an E&O policy the contractor will have a problem.

Even if there is an E&O policy, the issue is whether a drone claim is considered a claim. The term Aclaim@ is more than just a lawsuit against the insured but it is usually defined in the policy. *See Abifael v. Cigna Ins. Co.* (1992) 8 Cal.App.4th 145, 160.

Lastly, assuming there is a claim and there is E&O the inquiry will be with respect to the damages sought. There are limitations of damages in the policy and certain damages such as a drone intruding on one's privacy, an injunction or an administrative claim by the FAA, may be excluded.

C. Technology

Technology companies typically have technology E&O that protects their technology. When there is a drone incident the question may be, whether it was a technology glitch and as such, would it be covered by a technology policy of the operator and/or excluded by the policy of the construction professional? This is like a construction professional operating a car but with no direct auto insurance.

Tech policies vary and they will have to be analyzed. They may protect the software and the patent but what if the incident is based on human error?

D. Drone Insurance

Special insurance may apply to drone operators but the question is, whether the construction professionals can purchase it, obtain an endorsement or becomes additional insured on the operators' policies.