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UNDERSTANDING COINSURANCE PROBLEMS IN BUILDER'S RISK INSURANCE

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Do you understand coinsurance? If so, you are one of the lucky few. Coinsurance is one of the least-understood concepts in all of insurance law. Attorneys involved with construction projects need to have at least a working understanding of coinsurance, because missteps on the front end with regard to coinsurance can have serious consequences in the event of a claim. For properties under construction, coinsurance typically comes into play in connection with "builder's risk" insurance - insurance purchased to cover losses to property during construction.

Including a coinsurance clause in a builder's risk policy will typically mean lower rates. But in exchange for the lower rate, the policyholder takes on some risk of its own: If the limit of insurance that the policyholder specifies is less than required, then the clause will act to reduce the amount the policyholder may recover when it makes a claim, even if the claim is well below limits. Therefore, it is important that builder's risk insurance policyholders take care to prevent or reduce the risk posed by the coinsurance clause's penalty.

1. Builder's Risk Insurance.

The most common type of insurance coverage on property while it is under construction is builder's risk insurance. Builder's risk insurance provides a specialized form of property loss coverage that specifically applies throughout the construction process. A broad builder's risk policy insures against "all risks of direct physical loss of or damage to" the property covered, including a contractor's work and the materials and supplies used in construction of the building. Typically, the terms of the construction contract will dictate whether the contractor or the property owner is responsible for obtaining builder's risk insurance. Multiple parties are often covered by the policy, including the owner, the contractor, any subcontractors, sub-subcontractors, and financial institutions providing funds for the project (making the term "builder's risk" something of a misnomer).

There are several forms of builder's risk insurance, including (1) basic form, (2) completed value form, and (3) reporting form. The *basic form* provides a fixed amount of insurance and is commonly paired with a coinsurance clause. This form is undesirable and rarely used. As the value of buildings under construction increases, the limit of insurance must also increase; otherwise, the coinsurance clause will activate to penalize the insured. The *completed value form*, which is the most common type of builder's risk policy, determines the limit of insurance by the expected completed value of the project and also includes a coinsurance clause. However, the actual cost of construction will often exceed the original project estimate. Therefore, the completed value information should be updated if the project's actual cost increases beyond the initial estimate. Under the *reporting form*, the limit of insurance is set high enough to cover the expected complete value and the insured is required to report the actual value of the property periodically to the insurance company. Coinsurance clauses are not common in "reporting" forms of builder's risk insurance.

2. What Is Coinsurance?

Coinsurance is found in most forms of property insurance, of which builder's risk is a variety. The coinsurance clause typically found in the basic and completed value forms of builder's risk insurance policies can be a significant source of confusion.

Fundamentally, the coinsurance clause is a promise by the policyholder to purchase policy limits at a certain percentage of the property's value at the time of loss. If that promise is not met, the insured will be penalized for under-insuring the property, which means that the insured will have to absorb some of the loss itself. It is called "coinsurance" because *if* the penalty applies, the policyholder becomes a "coinsurer" with the insurance company, in that the policyholder will be responsible for paying part of the loss, along with the insurance company.

To identify a coinsurance clause within a builder's risk policy, look for phrasing similar to the following: "Need for Adequate Insurance. We will not pay a greater share of any loss than the proportion that the Limit of Insurance bears to the value on the date of completion of the building described in the Declarations." Coinsurance is usually set between 80% and 100%. As the coinsurance percentage increases, the amount of insurance required also increases. An insurance company may explain a coinsurance policy in the following way: "In exchange for lower rates, you agree to be insured for at least X% of the property's value at the time of loss. If you are not, you become a coinsurer and share in any partial loss. There is a formula in the policy that tells you your share: this calculation is commonly referred to as the 'did over should' formula."

Property-policy coinsurance is different from, but often confused with, coinsurance in the medical insurance context. In medical insurance policies, coinsurance indicates the amounts of a bill that the policyholder and the insurance company will pay. For example, if a medical insurance policy includes an 85/15 coinsurance and the bill is $100, the insurance company pays $85 and the policyholder pays $15. Although coinsurance terminology in the property insurance context is similar to the terminology used in the medical insurance context (for example, a builder's risk insurance policy may state "85% Coinsurance"), the way it applies to delineate responsibility for damage or loss is quite different.

3. The Coinsurance Penalty & How Insurance Companies Calculate the Penalty.

As noted above, coinsurance functions as a penalty if the property is under-insured. It applies when the limit of insurance purchased is less than a specified percentage of the insured's property value at the time of the loss. When the amount of insurance the insured is carrying meets or exceeds the specified percentage, the insured will recover 100% of its claim and will not be penalized by a coinsurance clause. In that situation, the coinsurance clause is not activated and does not reduce the insured's amount of recovery. However, when the insured is carrying less than the specified percentage, the coinsurance clause activates and the insured is "penalized."

The penalty is best understood through an example. Assume that a builder's risk insurance policy contains a 90% coinsurance clause. That clause means that the insured is required to carry insurance of at least 90% of the value of the property. If the property is valued at $500,000, the insured must maintain a minimum of $450,000 insurance on the property; otherwise, the coinsurance clause takes effect and the insured will be penalized by not receiving full coverage if there is a loss.

The amount of the penalty is determined through a set of two calculations. The first calculates the percentage of the claim the insured will be paid by dividing the amount of insurance the insured did carry by the amount that the insured was required to carry at the time of loss.

AMOUNT THE INSURER ACTUALLY CARRIED (DID CARRY)/

AMOUNT THE INSURER IS REQUIRED TO CARRY (SHOULD CARRY) = Y%

Continuing with the example above, if the insured was required to carry a minimum of $450,000 but was only carrying $400,000 of insurance (in other words, the construction project was underinsured), then the "Y" percentage of the claim the insurance company will pay is 88.9% ($400,000/$450,000 = 88.9%).

The second calculation applies this percentage to the insurance claim amount:

*AMOUNT OF INSURANCE CLAIM * Y%*

In our example, if the amount of damage or loss being claimed is $300,000, then the insurance company will only pay 88.9% percent of the claim: $266,700. This translates into a penalty of $33,300 for the insured as a result of not carrying the amount of insurance required by the coinsurance clause.

Sometimes there is a conflict between other portions of the policy and the coinsurance clause or an ambiguity in the coinsurance clause that could benefit the insured. In that event, coverage counsel may be needed to advocate for the interests of the policyholder.

4. Reducing the Risk of a Coinsurance Penalty In a Builder's Risk Policy.

There are many things an insured can do to avoid a coinsurance penalty. A major difficulty with coinsurance clauses is that they apply based on property value *at the time of the loss*, not when the policy is created or issued. To minimize the likelihood that an insured will be penalized by a coinsurance clause, it is crucial that the builder's risk insurance policy limit is as accurate as possible with regard to value.

When property is under construction, the value of the property generally increases, and may even increase beyond what was anticipated when the insurance was purchased. Therefore, the value must be regularly monitored and the insurance policy adjusted if necessary to accurately reflect the property's value. Otherwise, if a loss occurs and the value stated in the insurance policy does not match the value of the property at the time of the loss, the minimum insurance amount indicated in the coinsurance clause may not be met. This will cause the coinsurance clause to take effect and penalize the insured. Immediately reporting cost overruns so that the insurance policy limit may be raised will reduce the likelihood of underinsurance at the time of loss. The amount of any increased premium will usually be much less than the amount of the potential coinsurance penalty.

When reviewing and updating the policy limit of a builder's risk insurance policy, it is important to consider replacement costs and market value. Replacement cost estimates are influenced by the supply of labor, demand for labor, and costs of construction materials. Market value fluctuates with the economy. A decrease in market value, as a result of an economic downturn, may not necessarily reflect a decline in the construction or rebuilding costs.

Unless the construction is substantial, policyholders should avoid using the construction loan amount as the limit of property insurance. The amount of the construction loan is usually less than the completed value of the property. Therefore, using the construction loan amount may result in the coinsurance penalty kicking in if there is a loss.

Finally, insureds may reduce their likelihood of having to pay a coinsurance penalty by including overhead and profit in the completed value. If overhead and profit are omitted from the calculation of completed value, they could potentially account for a serious coinsurance penalty. The insurance policy must be examined carefully; however, be warned that some insurance policies instruct policyholders to exclude overhead and profit from the completed value calculation.

5. Policy "Adders" to Mitigate the Coinsurance Problem.

If coinsurance is a concern, the insured may want to contract around it. Insureds may request optional coverage to waive the coinsurance clause. An Agreed Amount Clause, Agreed Amount Endorsement, or Agreed Value Optional Coverage suspends the coinsurance clause when the insured carries the amount of insurance that the insurance company and the insured agree to be the property's actual value. Many insurance companies provide this option at an additional charge.

Inflation Guard Coverage is another coverage option that may reduce the risk of underinsurance. Inflation Guard Coverage automatically increases the amount of insurance annually by a percentage indicated in the declarations. This allows the insurance policy limit to increase with construction cost increases and relieves insureds from regularly monitoring, updating, and reporting to their insurance company construction costs increases.

CONCLUSION

Although coinsurance clauses create a risk for policyholders that a claim may not be paid in full, there are various ways to reduce that risk. Exploring and carefully selecting the form of builder's risk insurance, incorporating and negotiating optional coverage mechanisms to waive or reduce the risk of underinsurance, and regularly adjusting the insurance limit to reflect increases in the property's value will help policyholders avoid a coinsurance penalty kicking in.

RECEIVERS: A POTENTIAL SOLUTION TO A DISTRESSED PROJECT

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Sussman Shank

Here is an increasingly common scenario. A developer borrows millions of dollars from Lender Bank to finance the construction of a high-end condominium project. The developer owes millions of dollars to contractors and suppliers, who have asserted lien claims against the project. The developer defaults on the construction loan and cannot pay its contractors and suppliers. Before the project is even completed, contractors and suppliers begin to file lawsuits in state court to foreclose their lien claims. Lender Bank files cross and counterclaims to foreclose its trust deed.

The unfinished project poses code and safety violations, and may become damaged during the pendency of the complex foreclosure proceedings. Until the project is foreclosed and sold by the sheriff, the developer still owns the project, but has no financial ability to complete or secure it. The project, in its current unfinished condition, is worth less than the value of all the liens and trust deed debt. What can be done to preserve the project asset to maximize payment under the lien claims and trust deed?

Lender Bank should consider moving the court for appointment of a receiver. Arguably any valid lien claimant with an interest in the project can provisionally move for the appointment of a receiver under ORCP 80B(1), in order to protect its interest in the project. Lender Bank, however, is presumably the party with the most at stake and the best financial ability to advance the receivership costs, which typically are paid to the receiver prior to the sale of the property.

Generally, the authority for appointment of the receiver and procedural steps are set out under ORCP 80, and are likely provided for under Lender Bank's trust deed. Since Oregon does not have a statute outlining powers and responsibilities of a receiver (compare to Washington's Chapter RCW 7.60), a carefully crafted receivership order is needed to outline the receiver's powers and responsibilities, subject to further order or instructions from the court.

Under the authority of the court's order, the receiver can take measures to protect the project that the developer cannot afford to do and that Lender Bank and other lien claimants do not otherwise have legal authority to do. For instance, the receivership order can authorize the receiver to secure the project site from intruders, maintain building code compliance, and make necessary repairs. Additionally, the receivership order can grant the receiver authority to retain contractors and suppliers to complete the unfinished work and increase the value of the project prior to the foreclosure sale. Moreover, if the receivership order authorizes the receiver to sell the property, the receiver may be able to obtain a better price for the project than if sold at a sheriff's sale, thus increasing the amount of money Lender Bank and lien claimants will receive under their respective trust deed and lien foreclosure claims (after sorting out priorities).

If you represent a secured party involved in a complex, distressed construction project, you may want to consider whether seeking a receivership order is an appropriate remedy to maximize payment opportunities from the project.

NEW RULING CONCERNING CONTRACTOR LICENSING AND LIEN RIGHTS

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In recent years, the Construction Contractors Board ("*CCB*") has fined hundreds of contractors for failing to follow CCB licensing requirements. Many of these licensing issues relate to the type of work performed by the contractor and the question of who holds the construction license. In *Hooker Creek Companies, LLC v. Remington Ranch, LLC,* Case No. CV-11-090-MO (D. Or. June 9, 2011), these very issues caused Oregon District Court Judge Mosman to invalidate a construction lien for over five million dollars.

This case is currently on appeal before the U.S. Court of Appeals for the Ninth Circuit, Case No. 11-35566, and if upheld, Judge Mosman's thorough analysis of the text of Oregon's licensing statutes in this case could have far reaching effects.

Facts of the Case and Procedural History:

Remington Ranch, LLC ("*Remington*") is the developer and owner of the Remington Ranch project, a multi-million dollar destination resort in Prineville, Oregon. In January of 2010, Remington filed Chapter 11 bankruptcy. Prior to the bankruptcy filing, Hooker Creek Companies, LLC ("*HCC*") filed a claim of construction lien for over $5 million for labor, materials, services and equipment provided to the Remington Ranch project. HCC also filed a lawsuit in Crook County Circuit Court to foreclose its lien. After the bankruptcy was filed, Remington and the lender for the project challenged HCC's lien in the Bankruptcy Court on the basis that HCC was not entitled to claim a lien and that it was not properly licensed with the CCB.

HCC was the parent company to several subsidiary construction companies, including Hooker Creek Asphalt & Paving, LLC ("*HCAP*"). HCC argued that, although it was the general contractor for the project, it was the material supplier only and did not provide any of the labor for the Remington Ranch project. HCC's work on the Remington Ranch project related to initial excavation, road work and infrastructure work. HCC claimed that all labor was provided by HCAP. The construction contract ambiguously provided that "Hooker Creek" was the contracting party.

Although an addendum to the contract named HCC as the general contractor, HCC applied for a license with the CCB <u>after</u> it filed its claim of construction lien, but before it filed suit to foreclose its lien. HCAP was licensed with the CCB well before the construction contract was signed.

Judge Perris of the U.S. Bankruptcy Court for the District of Oregon invalidated HCC's construction lien on the grounds that the company was not properly licensed under ORS 701.131, and therefore, was not entitled to a valid construction lien. *See Remington Ranch, LLC v. Hooker Creek Companies, LLC*, Case No. 10-3093-elp (Bankr. Or. 2010). HCC then appealed Judge Perris' opinion and order to the U.S. District Court.

Issues:

None of the parties disputed that HCC was not licensed prior to filing its construction lien. HCC argued four points: (1) it was not a contractor required to obtain a license under ORS 701.131(1); (2) if the court found it was a "contractor," then HCC qualified for the safe harbor under ORS 701.131(2)(a)(B) because it obtained a license before it foreclosed its lien; (3) HCAP's license should be attributed to HCC because HCAP is a wholly owned subsidiary; and (4) at a minimum, the materials, equipment and services portion of the lien should be held valid, since a license is not required for these types of construction services.

ORS 701.131(1) requires all "contractors" to be licensed with the CCB at the time of contracting for the work, and continuously during the performance of the work. An important statutory consequence of a contractor's failure to meet the licensing requirements is the prohibition against perfection of a construction lien.

In ORS 701.005(5)(a), a "contractor" is defined as, "a person that, for compensation or with the intent to sell, arranges or undertakes or offers to undertake or submits a bid to construct, alter, repair, add to, subtract from, improve, inspect, move, wreck or demolish, for another, any building, highway, road, railroad, excavation or other structure, project, development or improvement attached to real estate, or to do any part thereof."

Holding and Effect on Oregon Construction Law:

Judge Mosman disagreed with HCC, and invalidated its entire claim of construction lien as a matter of law. This decision may seem simple on its face – HCC contracted to provide labor, and was not properly licensed. However, Judge Mosman's opinion analyzes ORS 701.131 in more detail than any prior case, and potentially impacts the future interpretation of this statute in general.

Judge Mosman quickly dispelled HCC's argument that it qualified for the safe harbor under ORS 701.131(2)(a)(B), and found that the statute requires a contractor to obtain the license prior to perfecting its construction lien. Additionally, Judge Mosman determined that HCAP's license could not be attributed to HCC because Oregon law clearly prevents the performance of construction work through another entity's license. *See* OAR 812-003-0100

Judge Mosman focused his analysis on the text of ORS 701.131(1), and HCC's arguments that it was not a "contractor," and was thus entitled to a lien for materials, services and equipment. Ultimately, by looking at the interplay of the text of ORS 701.010(3), 701.005(5)(a) and ORS 701.131(1), Judge Mosman held that HCC must be considered a "contractor" for the entire project, and may not exempt portions of its work from the licensing requirements.

ORS 701.131(1) states that a contractor may not perfect a construction lien for "work subject to this chapter." Judge Mosman interpreted this provision to mean that an unlicensed "contractor" simply may not perfect a construction lien, regardless of whether any specific work performed was "subject to this chapter." In this case, HCC was a "contractor" under ORS 701.005(5)(a) because HCC did not simply provide materials without fabricating them into the project, and thus did not qualify for any of the exemptions to licensure in ORS 701.010.

Prior to Judge Mosman's ruling, it seemed apparent that CCB regulations and Oregon statutes required contractors to be separately licensed, and general contractors could not rely on the licenses of their affiliated companies or subcontractors. Judge Mosman's decision confirms this and further clarifies that an unlicensed contractor could lose its lien rights for all work provided under the contract, even if not performed by such contractor and including the materials and equipment rental provided by the contractor.

Additionally, it is important to note that Judge Mosman's ruling is limited to construction liens. Judge Mosman found that ORS 701.131(1) is "not a restriction of a party's right to sue in general, but instead limits only the extraordinary privileges bestowed on those who strictly comply with the requirements of lien perfection." As a result, the question remains as to whether a contractor who fails to meet the CCB licensing requirements would still have the right to sue for breach of contract for all or part of the work, even though they would lost their right to a construction lien for any of the work provided.

PORTLAND'S DISPARITY STUDY

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The City of Portland and Portland Development Commission (PDC) hired a consultant in 2009 to conduct a "disparity study" concerning the City's and PDC's construction contracts and their construction-related professional service contracts.

A disparity study is a court-approved method to help public agencies decide whether there is a legal basis for programs to assist minority and women owned businesses (hereafter "MBEs" and "WBEs" and collectively "M/WBEs"). Such studies compare the availability of M/WBEs in the local geographic area to their actual use and then determine if there is a legally significant disparity between those two figures. In the absence of such a study, public agencies do not have legally sufficient evidence to establish race conscious measures and must ensure their actions are race and gender neutral. What follows is a general overview of the law in regard to disparity studies followed by a generalized discussion of the study's results.

As you are aware, government efforts to help MBEs and WBEs over the past three decades have resulted in a multiplicity of lawsuits as well as a voluminous number of court decisions and law review articles. It is beyond the scope of this article to differentiate between federal, state and city affirmative action programs, the different legal standards that may be applicable to each or the variety of approaches used by different consultants when conducting such studies. Nonetheless we can make some generalizations.

The starting point for legal analysis is *City of Richmond v. J.A. Croson Co.*, 488 US 469 (1989), in which the Court invalidated Richmond's minority contracting preference plan under the Equal Protection Clause of the 14th Amendment. The Richmond plan required prime contractors to ensure at least 30 percent of the contract dollars went to one or more MBEs.

Applying a standard of "strict scrutiny," the court held the plan violated the Equal Protection Clause because Richmond lacked sufficient evidence to show it had become a "passive participant" in a system of racial exclusion practiced by some in the local construction industry. In the absence of sufficient evidence, the Richmond failed to prove it had a "compelling governmental interest" to take race conscious measures to address the perceived problem. In addition, the court found Richmond's plan was flawed because it was not "narrowly

[1] Portions of this article were based on research and case summaries provided by Holland & Knight, LLP. The author acknowledges and appreciates its contribution. The comments in this article reflect my personal opinions and do not represent official policy of the City of Portland.

tailored" to remedy that discrimination.[2] "Narrow tailoring" includes consideration of race and gender neutral measures.

Since *Croson*, disparity studies have become the principal method to develop proof that the government's contracting process has been tainted by unlawful racial discrimination. The two main components of a disparity study are 1) statistical data and 2) anecdotal information. The statistical portion of the study gathers and analyzes data showing the availability and utilization of M/WBEs in the local market area. The anecdotal portion of the study consists of interviews with persons in the construction industry to determine if they have experienced racial discrimination.

The data showing availability and utilization is analyzed to determine if there is a statistically significant disparity between the availability of M/WBEs in the marketplace compared to their actual utilization. If a significant disparity exists and that disparity is coupled with anecdotal evidence showing discrimination, courts permit an inference of discriminatory exclusion from the marketplace and permit the government to take appropriate, but "narrowly tailored" remedial action.

What amount of disparity is statistically significant? Some courts have found a statistically significant disparity when a minority group receives 80% or less of the expected amount of contracts dollars it otherwise should receive based its presence in the marketplace. *Rothe Development Corp v. US Department of Defense,* 545 F3d 1023 (Fed. Cir. 2008). In other words, if MBEs should receive 10% of all contract dollars based on their availability in the marketplace and they receive less than 8%, that difference (20%) is statistically significant.

Data gathering for M/WBE utilization is relatively straightforward since it depends on historical records showing to whom contracts and subcontracts were awarded. This portion of the study may be time-consuming, but is not analytically difficult.

Data gathering and analysis of data to determine MBE availability is more complex. To determine "availability," the City's and PDC's consultant used an "enhanced custom census" approach. First, historical data was used to determine the geographic areas from which the City and PDC draws its contractors, which was determined to be five Oregon counties and two Washington counties.[3] Second, the consultant obtained information from Dun & Bradstreet on all businesses using the 8-digit industry codes most related to City construction and construction-related professional services contracts and subcontracts. That effort produced approximately 8,130 listings.

Third, the consultant attempted to conduct telephone interviews with all of the firms on the list created through Dun & Bradstreet records. Of the 8,130 firms listed, approximately 5,900 had accurate, working telephone numbers, and contact was successfully made with 3,726 firms. Of those firms, 1,700 stated they were not interested in participating in an interview. The remaining 2,000 firms were interviewed. The interviews concerned such topics as interest in, and capacity for, City and PDC projects, firm qualifications, firm specialization, the largest contract performed in the past five years, the length of time in business, and the racial, ethnicity and gender makeup of firm ownership. Only firms that consented to have interviews were used to generate data for the actual study.

Next, the consultants took that information and performed an analysis of the "relative capacity" of MBE and WBE firms. Relative capacity refers to the ability of a firm to take on work. Clearly, smaller firms have less capacity to take on large projects, or multiple small projects simultaneously, than larger firms and thus are less "available." Studies that fail to take "relative

[2] While racial programs may be subject to "strict scrutiny", programs addressed to gender may be subject to "intermediate scrutiny."

[3] The relevant market area was comprised of Columbia, Washington, Yamhill, Clackamas, Multnomah, Clark and Skamania counties.

capacity" into account have been criticized by some courts as insufficiently reliable. *Rothe, supra.*

The result of this "relative capacity" analysis was a decrease in overall availability for MBE and WBE firms when compared to their presence in the marketplace. For example, initial interviews showed that the total number of MBE firms in the area comprised 5.7% of the market while WBE firms (white women owned only) comprised 12.9% of the market, for a combined total of 18.6%.

After relative capacity was taken into account, however, the actual availability of MBE firms across the entire spectrum of City prime contracts dropped from 5.7% to 1.9%. It is important to remember that availability based on "relative capacity" is a "dollar weighted" average, which takes contract size into account.[4]

The *average* availability of MBEs over the entire spectrum of City contracts, however, is not the only picture presented by the data. For example, while the *average* availability for MBE contractors over all City contracts was 1.9%, the availability for all *subcontracted* work was found to be 4.8%. Thus, there are far more available MBEs for subcontract work on City projects than the *average* availability numbers portray.

Critics of the "relative capacity" approach to determining availability note that MBE firms may be smaller and unable to perform a greater quantity of work as a result of historical or current racial discrimination. That, of course, may well be true. Until the Supreme Court or other circuit courts reach different conclusions, however, it appears prudent for disparity studies to at least account for relative capacity in their conclusions.[5]

Indeed, the Supreme Court's decision in *Croson* to focus on current statistical data appears to reflect a judgment to take the playing field as it is found as opposed to where it "would" be if discrimination had never existed. If one cannot presume racial discrimination held down the availability of MBEs in the heart and capital of the Confederate States of America, it seems unlikely the Supreme Court will do so elsewhere.

PDC and the City currently are examining the results of their disparity studies. Generally speaking, City results showed some disparities for certain prime contracts and for certain subcontracts in certain, but not all, categories of contracts, such as contracts awarded without application of the City's current Good Faith Efforts program.[6]

In contrast, PDC's results showed statistically significant disparities in its "sponsored" construction projects. Sponsored projects are those where PDC provided financial support or loans to a developer, but did not actually execute the construction contract.

As a result of the disparity study, the City and PDC, together with citizen advisory groups, are in the process of examining a wide range of its existing procedures and policies to see if the City can remove barriers to the entry and advancement of MBE and WBE firms. It is anticipated that changes to City programs, and new programs, may begin to take shape beginning after February of 2012.

In summary, my best guess is that you will see changes to City programs designed to assist MBE and WBE firms next year because the disparity study shows there has been statistically significant disparity in the contracts awarded to

[4] The study separated PDC and the City when determining availability. The data in this article refers to availability for City contracts only. Availability and usage for PDC contracts was different. This should not be surprising since the City and PDC undertake different types of contracts. PDC is focused on urban renewal and often is involved with the development of property. The City has far more sewer and water contracts, road contracts and other infrastructure contracts than PDC.

[5] I am not a statistician so there may be other analytical methods to take this into account.

[6] The Good Faith Efforts program requires contractors to make good faith efforts to give opportunities to minority and women owned businesses by contacting them in advance of submitting a bid.

MBE and some WBE firms and those awarded to majority-owned firms. The extent of those changes, for now, remains undetermined. As those programs come into shape I will give you an update on what to expect from the City's bidding and contract process.

CHANGES TO THE CCB DISPUTE RESOLUTION SERVICES

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On July 1, 2011 the Construction Contractors Board (CCB) Dispute Resolution Services (DRS) program changed dramatically. This change was necessary because of the recent sharp slowdown in construction that resulted in a significant drop in the number of licensed contractors and the fees paid to the CCB. To adjust to this drop in revenue, the legislature made significant cutbacks in the CCB's budget for the DRS program. In order to accomplish this, the legislation eliminated the cost to send DRS files to the Office of Administrative Hearings for a contested case hearing or arbitration if a party challenged an order issued by the CCB. The statutory amendments necessary to accomplish this are in Senate Bill 939, sections 38 through 73.

For complaints filed on and after July 1, 2011, DRS will provide only mediation services. If the parties do not settle the complaint, the complainant must go to court and obtain a court judgment before DRS can send it to the contractor's surety for payment (that process may involve a contractual arbitration). Essentially, the CCB is using the court system to establish liability and damages, rather than an administrative process backed up with an administrative hearing.

Processing CCB complaints is relatively unchanged through the on-site meeting where the CCB Investigator Mediator meets with the parties at the job site to mediate the complaint and prepare a report of his or her observations if the complaint does not settle. If the complaint does not settle, the parties must go to court and the CCB will base its decisions on the resulting judgment.

Agency staff still must determine if the complaint is within the CCB's jurisdiction and how much of the judgment should be paid by the contractor's bond. To avoid hearings on these issues, the legislation provided that these decisions are orders not in a contested case. This type of order may be challenged in circuit court, rather than in an administrative hearing. (See Oregon Attorney General's Administrative Law Manual, Part V, 192 – 202 (January 1, 2008). Agency rules provide that the party challenging this kind of CCB order must file a petition for reconsideration before filing in circuit court. OAR 812-004-1260.

To implement SB 939, the CCB adopted amendments to its administrative rules. Most of the new rules are in OAR 812-004-1001 through 1600.

See also the following article by Alan Mitchell on these changes.

SIGNIFICANT CHANGES TO THE CCB DISPUTE RESOLUTION PROGRAM

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2011 Senate Bill 939 has made significant changes to the Dispute Resolution Program of the Oregon Construction Contractors Board (CCB). This article discusses some of those changes. For more information, check the CCB's web site.

Sections 38 through 73 of this bill set out major changes to the CCB's Dispute Resolution procedures. The bill was passed on July 6, 2011 and took effect that date. Section 54 expressly states a legislative intent that these statutory changes may be applied retroactively in order to process CCB complaints filed on or after July 1, 2011.

Prior to this bill, processing a CCB complaint first involved an on-site mediation and investigation. If that did not lead to a settlement, then the CCB would issue a proposed order and, frequently, refer the complaint to the Office of Administrative Hearings (particularly if one of the parties wanted to contest the proposed order). Under this bill, the second and third steps have been eliminated. Thus, the CCB complaint process now is essentially a "mediation-only" program.

For CCB complaints filed on or after July 1, 2011, ORS 701.145(5) has been amended to provide that, if the parties do not settle a complaint under CCB-assisted mediation efforts, then the complainant must file a circuit court action (which could be a small claims action) or an arbitration against the contractor. Once the complainant obtains a final judgment (which could include converting an arbitration award into a judgment), the CCB will issue a determination ordering the contractor's surety to pay that portion of the judgment that is within the CCB's jurisdiction. Those determinations will be orders that are not contested case orders.

One additional change is that the CCB will now conduct mediations for <u>all</u> complaints, not just owner versus prime contractor disputes. In this regard, the bill expressly authorizes telephone mediations (new ORS 701.145(4)).

Yet another impact of these changes is that a CCB Final Order can no longer be recorded to create a judgment lien (again, this is for complaints filed on or after July 1, 2011). This is because the CCB will not be issuing those orders. That ability had been set out in ORS 701.153, which cross-referenced ORS 205.125 and 201.126.

Two other impacts of these changes are the repeal of ORS 701.148 (which allowed the CCB to require that OAH hearings were held as arbitrations – since there are no OAH hearings, this is no longer needed) and ORS 87.058 (which allowed a property owner, in certain situations, to obtain a stay of a construction lien foreclosure action by filing a complaint with the CCB – now that CCB complaints will be decided judicially, there is no reason for this procedure).

Practitioners should also note that many of these changes have a "sunset" date of July 1, 2017. Thus for CCB complaints filed on or after July 1, 2017, Sections 56 through 72 of SB 939 reinstate most of the laws in effect prior to July 1, 2011, including the CCB's ability to use the Office of Administrative Hearings and the ability of an owner to obtain a stay of a construction lien foreclosure action.

CASE LAW UPDATES

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1. ARBITRATION: PUBLIC POLICY FAVORING BINDING ARBITRATION OF DISPUTES REQUIRES THAT AN AMBIGUOUS ARBITRATION AGREEMENT BE INTERPRETED AS BINDING, ABSENT OTHER EVIDENCE OF THE PARTIES' INTENT.

Gemstone Builders, Inc. v. Stutz, 245 Or App 91 (2011).

Plaintiff contractor sued defendant owners for breach of contract, unjust enrichment, and fraud. Defendants moved to compel arbitration under the construction contract, but the trial court denied defendants' motion. Defendants appealed, and the Court of Appeals reversed.

The Court of Appeals analyzed the language of the contract to determine whether there was an agreement to arbitrate the dispute and whether any arbitration clause was binding. Plaintiff argued that the contract language referring to arbitrating disputes was inconsistent, and thus should not be enforced. For example, plaintiff argued that the contract's attorney fee clause, which stated that "[i]f there is cause for suit, dispute, or action, both parties agree to submit to arbitration * * * prior to entering into the case of suit" was incompatible with terms in which the parties agreed that the contractor could pursue any remedy afforded at law or in equity for strict foreclosure. But the Court of Appeals read the latter term as referring to remedies only, not the proper forum to pursue the remedy.

The Court of Appeals also rejected plaintiff's argument that if the language of the attorney fee clause were intended to apply to all disputes, then the parties' agreement in the warranty section of the contract that required them to first submit any warranty dispute to arbitration would be rendered redundant. But any resulting redundancy did not create an ambiguity for the Court of Appeals.

Having decided that the agreement to arbitrate was unambiguous, the court considered whether the agreement to arbitrate was binding. Several clauses in the contract referred to arbitrating disputes "prior to" initiation of any suit, suggesting that the agreement was not binding. But the attorney fees term also specifically stated that decisions from the arbitrator would be binding on both parties.

Because the provisions are inconsistent with each other, the Court of Appeals held that the contract was ambiguous. But it was not too ambiguous to enforce. Instead, because the record contained no extrinsic evidence of the parties' intent concerning binding arbitration, the court turned to maxims of construction to resolve the ambiguity. The court found clear policies favoring arbitration as an alternative to litigation and not a step to prolong it. Based on these policies, the Court of Appeals held that the ambiguity would be resolved in favor of binding arbitration. Accordingly, the trial court erred when it failed to compel binding arbitration.

2. ATTORNEY FEES: A PREVAILING DEFENDANT MAY RECOVER ATTORNEY FEES UNDER A PREVAILING PARTY ATTORNEY FEE CLAUSE EVEN IF A THIRD PARTY IS BILLED FOR THE FEES AND PAYS THEM UNDER A SEPARATE AGREEMENT WITH THE DEFENDANT.

Menasha Forest Products Corp. v. Curry County Title, 350 Or 81, 249 P3d 1265 (2011).

Plaintiff Menasha Forest Products Corporation filed a declaratory judgment concerning a title insurance policy issued by Transnation Title Insurance Company in connection with an escrow closed by Curry County Title, Inc. ("CCT"). Menasha's escrow contract with CCT included a prevailing party attorney fees clause that applied to all claims arising out of the escrow. CCT and Transnation were jointly represented in defense of the action and, under a separate indemnification agreement between the CCT and Transnation, Transnation was billed and paid all attorney fees in connection with the action.

Ultimately, defendants prevailed on the declaratory judgment action, and the trial court awarded them attorney fees jointly. The Court of Appeals reversed, accepting Menasha's argument that CCT was not entitled to recover fees because it did not expend or incur any fees in defense of the action. Transnation had paid the attorney fees and, because of the indemnification agreement, CCT was not liable to pay them in the first place.

CCT and Transnation appealed to the Oregon Supreme Court who agreed with the trial court. The court rejected Menasha's argument that CCT was required to show that it had paid or was required to pay attorney fees in defense of the action in order to recover them under the contract language. Instead, the Supreme Court identified that CCT's entitlement to attorney fees must be analyzed separately from the indemnity agreement between CCT and Transnation. The court went on to hold that CCT incurred attorney fees because it was liable to pay them notwithstanding the indemnity agreement. For example, had Transnation not paid the attorney fees under the indemnity agreement, CCT was still liable to the attorney for those fees. Menasha was not entitled to the benefit of the indemnification agreement.

The court also rejected Menasha's argument that Transnation was not entitled to a joint award of attorney fees because it was not a party to the escrow agreement. The court found, however, that the relationship between Transnation and CCT with respect to the issuance of the title policy was one of principal and agent. As such, Transnation was a proper party to enforce the attorney fee right in the contract, particularly given that Menasha set forth no evidence that the agency relationship between Transnation and CCT did not extend to enforcing the escrow agreement.

3. ATTORNEY FEES/INSURANCE: ATTORNEY FEES MAY BE AWARDED UNDER ORS 742.061 ONLY AGAINST INSURERS WHO DELIVER THEIR INSURANCE POLICY OR ISSUE IT FOR DELIVERY IN OREGON.

Morgan v. Amex Assurance Co., 242 Or App 665 (2011).

Attorney fees against insurers may be awarded when claims are not settled within six months after proof of loss is filed under ORS 742.061. However, that statute is subject to ORS 742.001, which limits that chapter's application to "insurance policies delivered or issued for delivery in" Oregon. In an automobile insurance claim action in which judgment was issued against the insurer and in favor of an Oregon plaintiff arising from an automobile accident in Oregon, the trial court held that no attorney fees could be awarded to the plaintiff because the defendant was a Washington resident whose Washington insurance policy had been delivered to her in Vancouver. The court of appeals affirmed, finding that ORS 742.061 is controlled by ORS 742.001, including its limitation of application to Oregon insurance policies.

4. DAMAGES: EXTENDED HOME OFFICE OVERHEAD DAMAGES ARE DISTINCT FROM UNABSORBED HOME OFFICE OVERHEAD DAMAGES AND EXPERT OPINION BASED ON THE *EICHLEAY* FORMULA CANNOT BE USED TO ESTABLISH EXTENDED HOME OFFICE OVERHEAD DAMAGES.

Stellar J Corp. v. Smith & Loveless, Inc., 2010 WL 4791740 (D Or Nov 18, 2010).

In a federal breach-of-contract action in which the general contractor plaintiff sought recovery from a subcontractor defendant for "extended home office overhead" damages, the subcontractor filed a motion for partial summary judgment against those damages and prevailed before the Magistrate Judge. On review, the district court affirmed the grant of partial summary judgment dismissing the claim for overhead damages because plaintiff had asserted a claim for extended home office overhead losses but its expert had supported that claim by application of the *Eichleay* formula, which is used to calculate "unabsorbed" home office overhead losses. The general contractor failed to show that its home-office overhead was not a fixed expense or that it actually suffered additional home-office overhead expenses due to the subcontractor's delay in its work.

The court distinguished unabsorbed and extended overhead claims, noting that to recover extended home-office overhead costs, the general contractor was required to show "added overhead costs, which exceed its normally incurred fixed expenses attributable to ongoing business operations [because] * * * a contractor may still be able to complete the work without incurring 'added' overhead costs" (quoting *West v. All State Boiler, Inc.*, 146 F3d 1368, 1378-79 n4 (Fed Cir 1998).

The district court further held that it was appropriate for the court to adjudicate only a portion of the contractor's damages claim via summary judgment, rather than the entire damages claim, under Fed R Civ P 56.

5. INSURANCE/ADDITIONAL INSURED: THE "FOUR CORNERS" RULE IS INAPPLICABLE TO DETERMINE WHETHER THE PARTY SEEKING COVERAGE IS IN FACT AN "INSURED" PARTY UNDER THE POLICY.

Fred Shearer & Sons, Inc. v. Gemini Ins. Co., 237 Or App 468 (2010), *rev den.*, 349 Or 602 (2011).

A stucco manufacturer's liability insurance policy purported to cover distributors under a "vendors endorsement" for all "vendors of the [manufacturer]," but "only with respect to 'bodily injury' or 'property damage' arising out of 'your products' * * * which are distributed or sold in the regular course of the vendor's business." A homeowner sued its general contractor for losses resulting from leaking and mold caused by cracked stucco. The general contractor, in turn, brought third-party claims against the subcontractor that had sold and installed the stucco and against the stucco manufacturer. The subcontractor was a distributor of the manufacturer's stucco product. The manufacturer's insurer, Gemini Insurance, however, denied the subcontractor's tender of defense under the policy. In a declaratory judgment action to determine Gemini's duty to defend, the trial court held that the subcontractor was an insured under the vendor's endorsement and Gemini appealed.

On appeal, Gemini did not dispute the subcontractor's status as a distributor but claimed that the facts necessary to establish that it fell within coverage under the vendors endorsement could not be found within the "four corners" of the complaint, third-party complaint, or insurance policy. It objected to extraneous evidence used to establish the subcontractor's status as an insured, relying on the familiar recitation of the "four-corners rule" in *Ledford v. Gutoski*, 319 Or 397 (1994). The Court of Appeals rejected the subcontractor's apparent concession that the four-corners rule applied and held that that rule has no application in determining the preliminary question whether the subcontractor was an "insured" under the policy at all. The question of insured status under a policy is analytically distinct from whether the alleged losses are covered by the policy. The homeowner and general contractor, to properly plead their claims, need not plead facts relating to the subcontractor's relationship with the manufacturer's insurer or its status under the manufacturer's insurance policy.

The considerations underlying the four-corners rule have no application to the preliminary question of a party's status as an insured under the policy. Looking to the stipulated facts before the court, including extrinsic facts, the court affirmed the trial court's declaration that the subcontractor was an insured under the vendor endorsement. The court went on to determine coverage of the claims (applying the four-corners rule) and affirming the allocation of defense costs to Gemini.

6. INSURANCE/ASSIGNMENT OF CLAIM: AN EXCESS POLICY OF INSURANCE "FOLLOWS FORM" TO THE UNDERLYING PRIMARY POLICY ONLY TO THE EXTENT THAT IT UNAMBIGUOUSLY INCORPORATES ITS TERMS. ALSO, AN INSURED MAY VALIDLY SETTLE WITH A CLAIMANT BY ASSIGNING THE INSURED'S RIGHTS AGAINST ITS INSURER, WHO HAS DENIED THE CLAIM, UNDER ORS 31.825.

Portland School Dist. v. Great American Ins. Co., 241 Or App 161, *rev den.* 350 Or 573 (2011).

A contractor negligently caused a fire while reroofing Binnsmead Middle School in Portland in 2003. The contractor's primary liability insurer settled to the limits of its coverage, leaving more than $1 million in damages to collect from the contractor's excess liability carrier, who denied the claim outright. The school district and contractor entered into a settlement agreement under which the school district would sue the contractor in negligence for the remaining damages and the contractor would stipulate to entry of a judgment against it, confessing its negligence. After entry of the judgment, the contractor would, in exchange for a release, assign its rights against its excess insurer to the school district, who would then pursue recovery under that policy. This process intended to follow the requirements of ORS 31.825, which permits assignments of claims against insurers by judgment-debtors in exchange for releases.

When the school district sued the excess insurer on claims obtained through the assignment, the insurer argued that (a) the excess policy benefitted from an anti-assignment provision found in the underlying primary insurance policy through a "follow form" clause that purportedly adopted the terms and conditions of the underlying policy by reference, and (b) ORS 31.825 does not allow assignments of claims against insurers obtained through a pre-judgment settlement agreement with the insured. The Court of Appeals upheld the trial court's judgment awarding the school district judgment against the excess insurer for the remaining damages.

The excess policy did not use the term "follows form," common insurance parlance for the incorporation of coverage by an excess policy. Instead, it stated: "Except for the terms, conditions, definitions and exclusions of this [excess] policy, the coverage provided by this policy will follow the [underlying primary liability policy]." The trial and appellate courts found that this clause was not sufficiently clear to incorporate an anti-assignment clause that was located in the "terms and conditions" section of the primary liability policy and not the "coverage" provisions. Because the language was ambiguous about whether all of the terms or just the coverage terms of the underlying policy were to be incorporated, it applied the maxim that the policy would be construed against the drafter.

Additionally, the school district and insured contractor were held to have correctly followed the requirements of ORS 31.825 in the process set out in their settlement agreement. Although the parties contemplated a suit and entry of a judgment in the agreement, no enforceable release was given to the contractor and no enforceable assignment of rights was given to the school district until after the judgment against the contractor had been entered. Thus, the statute preserved the insured's claim against the excess insurer in the hands of the school district.

7. INSURANCE/BINDERS: A WRITTEN INSURANCE POLICY MAY NOT EXCLUDE CLEAR AND EXPRESS TERMS OF AN EARLIER ORAL BINDER. ADDITIONALLY, AN INSURED MAY RECOVER ATTORNEY FEES UNDER ORS 742.061 IN CONNECTION WITH AN ORAL BINDER OF INSURANCE.

Stuart v. Pittman, 350 Or 410, 255 P3d 482 (2011).

In connection with building a new home, plaintiff purchased a course-of-construction insurance policy through defendant Ronald Pittman, an insurance broker. Plaintiff requested coverage that would provide "safety net" or "catch-basin" coverage that would apply "in all instances that something goes wrong during construction." Pittman agreed to procure the coverage and did not communicate any limitations. During the course of construction, a storm damaged plaintiff's partially-complete house. Although the storm occurred several months after the oral binder of insurance was given, the insurer had still not delivered a policy to plaintiff. Plaintiff made a claim on the policy and Pittman told him that the damage should be covered. However, the written policy that was eventually issued to plaintiff included an exclusion for the type of damage that plaintiff suffered, so the insurer denied the claim.

Plaintiff sued Pittman and the insurer for breach of contract and prevailed at the trial court. On appeal, the Court of Appeals accepted defendants' argument that, under ORS 742.043, plaintiff's request for "safety net" coverage was not sufficiently clear and express to supersede the written exclusions in the policy.

Plaintiff appealed, and the Supreme Court reversed. Under ORS 742.043, oral binders include all the normal terms of the policy, including endorsements and exceptions except as superseded by clear and express terms of the oral binder. Applying the analysis prescribed in *PGE v. Bureau of Labor and Industries*, the Supreme Court held that to be sufficiently clear and express, terms of the oral binder must not be vague or obscure. Here, a request for "safety net" or "catch-basin" coverage in "all instances that something goes wrong" was not vague or obscure; the language essentially referred to an "all-risk-policy." Because there was evidence in the record from which the jury could reasonably conclude that plaintiff had requested a policy different from that eventually expressed in the written policy, the trial court did not err.

The Supreme Court also affirmed the trial court's grant of attorney fees under ORS 742.061. Defendants had argued that plaintiff was not entitled to attorney fees because the statute only applied to written policies, not oral binders. But the Supreme Court rejected the argument on two grounds. First, the jury's conclusion that there was an enforceable oral binder of insurance meant that, under ORS 742.043, the written policy issued by defendants was deemed to include all the terms of the oral binder. Second, the Supreme Court relied on prior precedent that allowed attorney fees under oral binders.

8. INSURANCE/DUTY TO DEFEND: AN INSURER'S DUTY TO DEFEND DOES NOT ARISE WHEN THE ALLEGATIONS OF THE COMPLAINT FAIL TO SPECIFICALLY PLEAD THAT THE RESULTING DAMAGE COVERED BY THE POLICY NECESSARILY RESULTED FROM THE DEFECTS ALLEGED IN THE COMPLAINT.

State Farm Fire & Casualty v. American Family Mutual, 242 Or App 60, 253 P3d 65 (2011).

Homeowners asserted a claim against Edgewater Homes, Inc., for breach of contract, breach of implied warranties, and negligence arising out of the construction of an EIFS cladding system at their home. Edgewater tendered the claim to its insurers, plaintiff State Farm Fire & Casualty Company and defendant American Family Mutual Insurance Company. State Farm accepted the tender, but American Family did not.

Thereafter, State Farm brought a declaratory judgment action against American Family seeking a declaration that American Family was obligated to defend Edgewater and contribute to the cost of defense incurred by State Farm. The trial court ruled in State Farm's favor, concluding that the claim alleged a time period covered by American Family's policy, an occurrence as defined by the policy, and damages covered by the policy.

American Family appealed and the Court of Appeals reversed. On appeal, American Family asserted that the allegations of the complaint failed to allege property damage within the terms of the policy because the allegations did not specify resulting damage beyond damage to the work itself. The court focused on whether the homeowners' complaint against Edgewater, without amendment, would allow them to offer evidence and recover damages for injury to property other than the EIFS cladding itself.

To answer the question, the court analyzed the pleading rules under ORCP 18 B. Compensatory damages for injury to real property are divided into categories of general and special (or collateral) damages. General damages naturally and necessarily result from the injury alleged, whereas special damages may flow naturally from the injury, but not necessarily. General damages are not required to be pled with specificity, but special damages are. If the exact nature of special damages is not pled with specificity, the court will exclude evidence of them and preclude recovery on them.

Upon review of the homeowners' complaint, the court concluded that none of the allegations of property damage extended beyond EIFS cladding itself. It further concluded that, although water damage to other building components may naturally result from defects in the EIFS cladding, water intrusion was not a "necessary result" of the defect. Because the homeowners failed to specifically plead resulting losses as special damages, their complaint did not trigger coverage for resulting property damage under American Family's policy.

9. INSURANCE/SUBROGATION: INSURER WHO PAID UNDER POLICY IS NOT ENTITLED TO RECOVER AGAINST OTHER INSURERS UNDER THEORIES OF CONTRIBUTION, INDEMNITY, AND SUBROGATION WHEN THE OTHER INSURERS WERE NOT LIABLE AT THE TIME THE INSURER MADE PAYMENT BECAUSE OF LIMITATION PERIODS IN THE OTHER INSURERS' POLICIES.

Fireman's Fund Insurance Company v. United States Fidelity and Guaranty Company, No. CV-09-263-HU, 2010 WL 1959148 (D Or May 17, 2010).

The Fireman's Fund Insurance Company insured a building under a policy period beginning July 1, 2000. The owner of the building discovered water damage that had been occurring since construction of the building in 1998. Fireman's Fund eventually paid under its policy and brought an action against other insurers who had insured the property after construction and before the Fireman's Fund's policy went into effect. Fireman's Fund asserted claims for equitable contribution, common law indemnity, and equitable subrogation. The other insurers moved for summary judgment, which the court granted.

All of the other insurers' policies had language that included a limitations period that required all actions for property damage under the respective policies to be brought within two years from the date of the damage. Moreover, the applicable policy language did not include a discovery rule. Accordingly, under the language of the contracts, the prior insurers could not have been liable under the policies for a claim that was brought before June 30, 2002, two years from the expiration of the latest policy period. In this case, however, the insured did not assert a claim until 2003. Because under the law of subrogation, Fireman's Fund was subject to all of the policy defenses that would be valid against the owner, the limitations defense was valid against Fireman's Fund.

The analysis under the indemnity and contribution theories turned on the same facts. Because of the policy limitations period, the other insurers owed no legal obligation to pay the policy when Fireman's Fund made payment in 2005. Although both indemnity and contribution claims have their own separate statute of limitations period, a plaintiff cannot recover unless it discharged a duty owed by the party from whom it seeks indemnity or contribution. Claims for indemnity and contribution cannot revive the underlying statute of limitations when it ran before the insurer made the payment for which it is seeking contribution and indemnity.

10. NEGLIGENCE: A PLAINTIFF MAY PURSUE A CLAIM FOR NEGLIGENT CONSTRUCTION NOTWITHSTANDING A CONTRACTUAL RELATIONSHIP WITH THE BUILDER IF THE PLAINTIFF ALLEGES THAT THE BUILDER UNREASONABLY CAUSED FORESEEABLE PROPERTY DAMAGE AND THE CONTRACT DOES NOT ELIMINATE THE CONTRACTOR'S LIABILITY FOR COMMON LAW NEGLIGENCE. IN SUCH CASES, THE STATUTE OF LIMITATIONS ON THE NEGLIGENCE CLAIM IS TWO YEARS FROM DISCOVERY OF THE DAMAGE.

Abraham v. T. Henry Construction, Inc., 350 Or 29, 249 P3d 534 (2011), recons. denied (May 5, 2011).

Plaintiffs hired defendants to build a home, which was substantially completed in 1998. More than six years later, plaintiffs discovered water damage and brought claims against defendants for breach of contract and negligent construction. The negligent construction claim was based on three theories: common law negligence, violation of a duty created by a special relationship, and negligence *per se* based upon violation of the Oregon Building Code.

Defendants moved for summary judgment against the contract claim because it was not brought before the six-year statute of limitations had expired, and against the negligence claim because plaintiffs and defendants did not stand in a special relationship to each other. The trial court entered judgment in favor of defendants on both claims. With respect to the negligence claim, the trial court held that under *Jones v. Emerald Pacific Homes, Inc.*, 188 Or App 471 (2003), a homeowner who contracts with a builder cannot assert a negligence claim absent a special relationship with the contractor, and there is no special relationship between a homeowner and a contractor.

The Court of Appeals affirmed the decision on the contract claim, but reversed on the negligence claim. First, the Court of Appeals held that when a construction contract merely incorporates a general obligation of reasonable care, *Jones* correctly requires that the plaintiff must show a standard of care independent of the contract arising from a special relationship, statute, or administrative rule. Plaintiffs' arms-length contract with defendants to build the home, however, did not create the type of special relationship that could support the negligence claim. But the Court of Appeals also held that the Oregon Building Code created a standard of care independent of the contract, thus plaintiffs' allegations that their damage arose from defendants' violations of the Building Code supported a negligence claim.

Defendants appealed and the Supreme Court affirmed, though on different grounds. The Supreme Court first noted that tort liability based on common law duty to avoid foreseeable injury to others exists whether or not the parties are in contract, unless the contract modifies or eliminates the common law duty. Parties do not waive common law tort rights merely by entering into a contract.

The Supreme Court then rejected defendants' argument that, under *Georgetown Realty v. The Home Ins. Co.*¸ 313 Or 97 (1992), a party to a contract could only bring a tort claim arising out of a breach of contract if a special relationship existed that created an independent standard of care. The Supreme Court distinguished *Georgetown* because it was a case in which a party seeking economic loss had to stand in a special relationship to recover for negligently-caused economic harm, whereas plaintiffs' harm in this case involved property damage.

Finally, without mentioning *Jones*, the Supreme Court held that the parties did not modify or eliminate the common law duty to avoid foreseeable injury simply by including in the contract language that the contractor must complete its work in a workmanlike manner and comply with building codes. Such a contractual promise exists whether or not it was included in the contract, so a breach of the promise could give rise to both contract and tort liability. Because plaintiffs had alleged that defendants unreasonably caused foreseeable property damage and the parties' contract did not eliminate defendants' common law duties, plaintiffs were entitled to proceed on the negligence claim.

Although not asked to determine the limitations period for a claim arising out of property damage caused by negligent construction, the Supreme Court included in a footnote that the applicable statute was ORS 12.110. Under ORS 12.110, tort claims must be brought within two years from the date they accrue, which the court said was normally upon discovery, limited only by the statute of repose in ORS 12.135.

Because the court was not asked to decide this issue, plaintiffs moved for reconsideration. In particular, plaintiffs asserted that the footnote could foreclose application of the six-year limitations period under ORS 12.080(3) (injury to an interest of another in real property) for claims of negligent construction. The Supreme Court, however, refused to modify its opinion.

11. PRESERVATION OF ERROR: THE PLAIN ERROR EXCEPTION TO ORCP 59 H IS NARROWLY CONSTRUED.

State v. Guardipee, 239 Or App 44, 243 P3d 149 (2010).

Counsel for defendant in this criminal case proposed a jury instruction to which the State objected. The court accepted the State's position and refused to give the jury instruction. Defense counsel failed to raise the objection again after the jury was instructed as required by ORCP 59 H(1).

On appeal, the defendant asserted that the court could still review the failure to give the instruction, notwithstanding the failure to comply with ORCP 59 H, because of the court's ability to review a plain error on the face of the record. The court rejected defendant's argument, holding that only in narrow and rare circumstances would the court circumvent the broad conclusive effect of ORCP 59 H. The case at hand did not present the facts to which deviation from the rule would be warranted.

12. PRESERVATION OF ERROR: OBJECTIONS TO JURY INSTRUCTIONS UNDER ORCP 59 H MUST BE SUFFICIENTLY SPECIFIC TO ALLOW TRIAL COURT TO CORRECT ALLEGED ERROR.

Hammer v. Fred Meyer Stores, Inc., 242 Or App 185, 255 P3d 598, *rev. den.*, 350 Or 716 (2011).

Plaintiff was injured in defendant's store when removing product from an end-cap display. Before the case was sent to the jury, plaintiff asked that the jury be given a *res ipsa loquitur* instruction. Defendant objected, contending that the instruction was not warranted by the evidence, that the instruction failed to address the element of exclusive control, and that the instruction improperly burdened the defendant to prove the absence of its own negligence. The court gave the instruction anyway, after which defendant objected, again restating that the evidence did not support the *res ipsa loquitur* instruction and asserting that the case should have gone to the jury on a regular negligence instruction.

The Court of Appeals held that defendant failed to properly preserve any error with respect to the jury instructions. Defendant's post-jury instruction objection was not sufficiently particular to allow the trial court an opportunity to correct the error. Based on its review of the record, the Court of Appeals held that nothing in defendant's objections before or after the giving of the *res ipsa loquitur* instruction informed the judge how the instruction failed to address an essential element of the doctrine or otherwise was inaccurate. Generally arguing that the instruction should not be given was not enough. Accordingly, the court did not consider the merits of whether the instruction was proper.

13. WAGE AND HOUR: A GENERAL CONTRACTOR IS NOT THE "EMPLOYER" OF ITS SUB-SUBCONTRACTOR'S EMPLOYEES UNDER APPLICABLE WAGE AND HOUR LAWS, WHEN THE EMPLOYEES PERFORM FRAMING WORK ON ONLY ONE OF THE GENERAL CONTRACTOR'S PROJECTS.

Gonzales v. Sterling Builders, Inc., No. 08-CV-943-BR, 2010 WL 1875620 (D Or, May 6, 2010).

General contractor LC Construction and Remodeling, Inc., contracted with Sterling Builders, Inc., to provide framers for a construction project. Sterling Builders, in turn, subcontracted with Hammer Construction, LLC, to provide the framers to perform the work on the project. Although LC Construction paid Sterling Builders all periodic payments due under the contract, the framers walked off the project asserting they had not been paid. Later, several of the framers initiated claims under the Fair Labor Standards Act ("FLSA") and Oregon's wage and hour laws.

The court granted summary judgment in favor of LC Construction because plaintiffs failed to establish that they were employees under the multi-factored tests to determine employee status under the FLSA. *Gonzales* provides the practitioner a detailed framework for how a court could approach all the factors in a wage and hour case. With respect to issues that may be applicable in a broad number of cases, the court held that a general contractor's authority to set the overall schedule for a construction project did not equate to having the authority to supervise and control a particular subcontractor's employee's work conditions.

The court also held that, because this was the only LC Construction project that the plaintiffs had worked on, plaintiffs could not show that they were the equivalent of LC Construction employees based on being moved from work site to work site.

Because the application of the Oregon wage and hour laws tracks the FLSA, the court granted summary judgment on the Oregon wage and hour law claims for the same reasons.

14. WAGE AND HOUR: A CONTRACTOR MAY BE AN "EMPLOYER" OF THE DRYWALL SUBCONTRACTOR'S EMPLOYEES WHEN THE CONTRACTOR EXERTED A CERTAIN DEGREE OF CONTROL OVER THE LABORERS AND USED THE SAME LABOR CREWS ON SEVERAL PROJECTS.

Chao v. Westside Drywall, Inc., 709 F Supp 2d 1037 (D Or 2010).

The United States Department of Labor ("DOL") brought a claim against Westside Drywall, Inc., on behalf of more than 50 laborers under the Fair Labor Standards Act ("FLSA"). The DOL claimed that Westside had improperly employed drywall laborers through subcontract relationships in an effort to avoid the requirements of the FLSA minimum wage and overtime rules. Westside filed several motions for summary judgment against the claims related to various workers or classes of workers. In general, the court denied the motions because Westside was the employer of the laborers.

As with most wage and hour cases, the court's analysis of whether the particular workers were "employees" of Westside was a heavily fact-dependent analysis. With respect to issues that may be applicable in a broad number of cases, the court held that the following supported the conclusion that the workers were employees: Westside specifically determined the project sites to which the work crews were assigned, decided what materials were to be used on each project, and required the laborers to track time and provide the time sheets to Westside for payment. Westside's supervisors also regularly visited the job sites and "supervised" the workers. Moreover, some of the workers were paid on an hourly basis with no opportunity for commission or bonus as opposed to a true subcontractor relationship in which the workers could realize a greater benefit through efficiencies of work. Finally, the workers tended to work exclusively on Westside projects during the relevant time frame.

Chao also provides a good reminder about adhering to evidence rules when submitting declarations in support of summary judgment. For example, both parties had submitted deposition transcripts that did not include a reporter's certification so the court refused to consider them when making its ruling. Other declarations were submitted without recitation that they were made under the penalty of perjury, so they too were disregarded.

"CLASS OF ONE" STATUS AND DEVELOPMENT PERMITS

Scot Sideras
Clackamas County Counsel

The Ninth Circuit Court of Appeals recently issued a decision that is of particular import to projects burdened by a failure to receive permits or an idiosyncratic approach to granting permits. *Gerhart v. Lake County Montana*, 637 F.3d 1013, 2010 U.S. App. LEXIS 27112 (US Supreme Court certiorari denied by *Gerhart v. Lake County, 2011 U.S. LEXIS 5784 (U.S., Oct. 3, 2011).*

Plaintiff Allan Gerhart was a property owner and resident of Lake County, Montana. In 2007, he found the easement from his neighbors was no longer useful as a means to access his property, so he built his own access road and approach from his house to Juniper Shores Lane, a county road that borders his property. As he was completing his approach, Gerhart was informed by a County employee that the County requires permits for road approaches.

Gerhart filed an approach permit application, and originally was told by the same County employee, who was the Road Superintendent of the County, that his approach looked good. That employee signed off on

Gerhart's permit, and forwarded it to the three County Commissioners, which was the usual procedure. What was not usual is that the Road Superintendent was later told that Gerhart's permit application was to be "put on hold" by the Commissioners, and several months later Gerhart was sent a letter which informed him his permit was denied, without explanation.

Mr. Gerhart learned that most of his neighbors had created their own approaches to Juniper Shores Lane, though none of them had applied for a permit. When Gerhart received his denial letter, his attorney sent a letter to the Commissioners noting that all the other neighbors did not get permits. In response, Gerhart was sent a letter from the Commissioners, stating for the first time several reasons for denying his application, suggesting he had an alternative access to his property, and citing safety concerns.

When the parties were not able to resolve the dispute, Gerhart filed a suit under 42 U.S.C. Sec. 1983, alleging the County and individual Commissioners violated his due process and equal protection rights.

The district court granted summary judgment to the Defendants after concluding Gerhart could not establish a constitutional violation. On appeal, the summary judgment was affirmed as to the County and the individual Commissioners on Gerhart's due process claims, but the court reversed the grant of summary judgment to the individual Commissioners on Gerhart's equal protection claim, and the case was remanded for trial.

The Due Process Claim: To succeed on either a procedural or substantive due process violation claim, Gerhart needed to show he was deprived of a constitutionally protected property interest. While it is possible to have a property interest in a government benefit, the claimant must be able to show a legitimate claim of entitlement. Gerhart's due process claim failed because the permit process allowed for government discretion in the decision making process.

Because discretion was not limited by Montana law, Gerhart had no entitlement to an approved permit simply because he filed the correct paperwork. The fact that Gerhart thought he was approved based on the County employee's representations, or the fact the Commissioners had generally been lenient in other landowners' cases did not give Gerhart an entitlement to an approved permit. Gerhart therefore did not have a protected property interest in an approach permit, and so did not have a due process violation.

The Equal Protection claim: The Supreme Court has recognized that "an equal protection claim can in some circumstances be sustained even if the plaintiff has not alleged class-based discrimination, but instead claims that she has been irrationally singled out as a so-called 'class of one.'" *Village of Willowbrook v. Olech*, 528 U.S. 562,564 (2000). To succeed on his "class of one" claim, Gerhart must demonstrate that the Commissioners: (1) intentionally (2) treated Gerhart differently than other similarly situated property owners and (3) without a rational basis.

The Court found that the facts in this case make it very arguable that the Commissioners intended to treat Gerhart differently from other petitioners. The Court of Appeals found that the record showed there were triable issues of fact on this prong of the test. Similarly, the Court was persuaded that facts exist in the record to support Gerhart's claim that he was treated differently than other permit applicants. Finally, the record also supports a conclusion that there is a genuine issue of material fact as to whether the Commissioners had a rational basis for treating Gerhart differently from similarly situated property owners.

Because the court found there were genuine triable issues of fact as to the merits of Gerhart's equal protection claim, it was not proper to grant the Commissioners a summary judgment. As noted above, the case was therefore remanded for trial to evaluate the equal protection violation claim.

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