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THE NEW AND IMPROVED ORCP 68: IS YOUR ATTORNEY FEE PETITION AFFECTED?

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For most attorneys, the nuances of ORCP 68 are not part of their everyday practice and do not become mission critical until after obtaining a prevailing party determination on their underlying claims. At that time, there is an incredible flurry of activity to review and strictly comply with the rule. Knowing that this is the case, the following is a brief summary of the recent changes to ORCP 68 and why they are important to your practice.

Significant changes to ORCP 68 became effective on January 1, 2016; the most substantial being to subsection C thereof. The first noteworthy change was the inclusion of ORCP 68C(4)(d)(ii) titled: "**Discretion related to time of filing**." This new provision specifically grants the trial court discretion to enlarge the time to file and serve a statement of attorney fees, costs and disbursements; as well as the objections or responses relating thereto. This change is likely in response to the procedural issues outlined in *Ornduff v. Hobbs*, 273 Or App 169, 359 P3d 331 (2015).

In *Ornduff*, a judgment of restitution was entered in favor of plaintiff. In response, plaintiff filed and served a "Motion for Entry of Supplemental Judgment re: Attorney Fees," to which he affixed his ORCP 68 statement for attorney fees. It was later learned that plaintiff's Motion was not docketed by the trial court until 16 days after entry of the restitution judgment (or two days past the 14 day deadline). Defendants filed supplemental objections challenging plaintiff's request for fees and costs as untimely and plaintiff responded with a motion under ORCP 15D to permit the late filing. The trial court granted plaintiff's ORCP 15D motion and entered a supplemental judgment for attorney fees and costs.

The defendants appealed the trial court's decision with their primary objection being that a statement for attorney fees, costs and disbursements is neither a pleading nor a motion within the meaning of ORCP 15D and the trial court therefore lacked the discretion to enlarge the time to file the statement. On review, the Court of Appeals noted that Oregon "case law is clear that a court cannot award attorney fees if a fee statement is filed outside of the 14-day period specified [by the rule]." *Id.* at 175, *citing Jaffe v. The Principle Company*, 215 Or. App. 385, 391, 170 P3d 4 (2007). The Court also noted that ORCP 13, ORCP 15, and ORCP 68 were "enacted at different times and are not fully harmonious." *Id.* at 181. However, the Court ultimately found that an attorney fee statement is a pleading within the meaning of ORCP 13B and ORCP 15D, and the trial court had discretion to allow plaintiff's untimely statement.

While *Ornduff* was pending on appeal, the Oregon Council on Court Procedures promulgated the recent amendments to ORCP 68, including the addition of ORCP 68C(4)(d)(ii). By adding this new language, the Council addressed the issues raised in *Ornduff* conclusively. As a result, there is now a mechanism to seek an enlargement of time when the circumstances justify the same.

The next sizeable change occurred to ORCP 68C(5)(b). Prior to January 1, 2016, the rule only addressed the situation whereby attorney fees, costs or disbursements were requested after entry of a general judgment. There was no discussion in the rule about the award of fees, costs or disbursements following entry of a limited judgment. ORCP 68C(5)(b)(ii) now confirms that trial courts may award or deny attorney fees, costs or disbursements following entry of a limited judgment "if the court finds no just reason for delay" – tracking the language in ORCP 67B.

The final notable change to ORCP 68 is the brand new addition of ORCP 68C(7) regarding seeking attorney fees incurred in enforcing judgments. It is not uncommon for attorneys to spend substantial fees in the effort to collect on a client's outstanding judgment. However, prior to January 1, 2016, it was procedurally unclear how to recover those additional fees. To address this uncertainty, creditors' rights attorneys frequently included language in their general judgments stating that the judgment creditor was entitled to later seek a supplemental judgment for attorney fees incurred to collect on the judgment and were permitted to move for entry of the same. The recent addition of ORCP 68C(7) makes such precautionary measures of less significance.

Specifically, ORCP 68C(7)(a) addresses that a judgment creditor may file a supplemental statement for fees incurred in collecting or enforcing a judgment at any time after entry of the judgment being enforced. However, unless good cause is shown, a party can only file one supplemental statement within the first year of entry, and one per year thereafter. In turn, ORCP 68C(7)(b) confirms that the procedure for filing and serving a supplemental statement tracks the same procedure for an initial statement for attorney fees, costs and disbursements.

Overall, the recent changes to ORCP 68 provide attorneys more clarity regarding when and how to file a statement for attorney fees, costs and disbursements, and trial courts more discretion on the timing thereof. However, it is important to recognize that these changes are already in effect and will impact our attorney fee petitions going forward. Due to the time sensitive nature of attorney fee requests, it is essential that practitioners, including those of us in the construction law practice, understand these changes and how they may touch on our pending actions.

COURT ANNEXED ARBITRATION - TIPS AND OBSERVATIONS FROM A SOMETIME ARBITRATOR

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The purpose of this article is to share some tips and observations on the court annexed arbitration program from the perspective of a sometime arbitrator. I have been serving as an arbitrator for about five years. The bulk of my appointments come from Multnomah County though I get some from Clackamas County. Serving as an arbitrator is a small fraction of my practice. I serve for a number of reasons, one of which is that I think it is healthy to have a sizable pool of arbitrators from varied practice areas. One of the reasons I continue serving is because of what I learn from other attorneys as they present their cases.

Every arbitrator brings their own experience to the arbitration process. My personal experience has led me to focus on minimizing the litigation expense associated with these relatively low dollar value cases. What follows are some are some tips and observations that may help you cost effectively arbitrate your cases.

Arbitrator Fees: My experience is that the arbitrator fee schedule is cumbersome for everyone involved. Frequently parties miss deposit deadlines or, in the alternative, pay the entire fee before it is due in order to avoid deadlines. I practice at a small firm, so I try to minimize my office's time on accounting tasks. A popular solution has been to deviate from the Multnomah County fee schedule by requiring two payments: $200 upon appointment, and $300 due 14 days prior to any hearing. The payments are earned upon receipt, so it limits my accounting. For the parties, it encourages settlement because the litigants know what they have in the case. The total arbitration cost of $500 is preserved.

Motion for Summary Award: A motion for summary award is almost always a wasted motion, and I caution parties to never file one except in circumstances that are dispositive of the entire case. Cases generally come from one of three categories: credit card collection; personal injury; and varied contract litigation. A motion for summary award is invited in credit card collection cases. A motion for summary award would only be productive in other types of cases if there is a statutory defense based on the statute of limitations, contractor licensing (ORS 701.131), or similar dispositive defense.

Discovery Disputes: Motions to compel production are expensive and time consuming. Rather than a formal motion, I prefer a short e-mail explaining what discovery is being sought and why it should be allowed. Objections are made in a rebuttal e-mail. Citations to published cases are only sometimes helpful. I am appointed by the court, so I am bound to follow previous rulings from the court. It follows that the better authority is a bench opinion from a sitting judge in the relevant venue or a citation to the Multnomah County Civil Motions Panel Statement of Consensus. See: http://courts.oregon.gov/Multnomah/docs/CivilCourt/CivilMotionPanel_CivilMotionPanelStatementOfConsensus.pdf

Attorney Fee Cases: Many of my cases involve statutory fees, typically ORS 20.080 or ORS 20.082. Going into the hearing, I suspect there may have been a prelitigation offer and the real issue is whether my award will be sufficient to trigger an additional award of statutory attorney fees. That's fair. But what has come as a surprise is the number of times both attorneys signal the amount of the prelitigation offer. For example, the prayer is $10,000, but plaintiff's counsel argues that an award of $6,000 would be fair. In turn, defense counsel argues that an award of $4,500 would be fair. The arbitrator now understands that the offer is more than $4,500 but less than $6,000. I do not know if this bracketing impacts my deliberation, but I think counsel should have a strategy should opposing counsel signal the amount of a prelitigation offer.

Leading Witnesses: Leading witnesses is a consistent issue during my hearings. My suspicion is that the informal setting of the conference room leads attorneys to drop the formalities of courtroom examination. Also, most arbitrations are scheduled for three hours, so the perceived time crunch may lead attorneys to hurry through their examinations by leading witnesses. I allow leading questions as long as opposing counsel does not make an objection. But attorneys asking leading questions do so at their peril. Awkward but honest testimony provided directly from a witness is almost always perceived better than the robotic testimony that is the product of leading questions. Be sure to prepare your witness to tell their story in their own words.

Arbitrator Questions: Direct examination almost always leaves me wanting to ask some questions of the witness, but I will only do so if invited by counsel. I think many arbitrators take this approach. Generally, my questions will be helpful to your case, especially if you have been leading your witness or the witness is nervous. What I will not do is help either party develop a claim or a defense, though admittedly, my questions may prompt examination from opposing counsel. My goal is to understand the testimony and make the best decision possible. Prior to the hearing, attorneys should consider whether they want the arbitrator to question their witnesses. If so, they should affirmatively invite the arbitrator to ask questions and advise their clients that the arbitrator may ask questions.

Construction Considerations: My experience is that construction cases are more complicated than other types of cases. These cases frequently require more witnesses and exhibits than cases of similar dollar value. Court annexed arbitration is relatively informal, so there are ways to use technology to minimize the expense associated with the arbitration. Consider the following:

i. Construction cases benefit from photos, if not video, of the construction site and the specific work at issue. I would consider iPhone videos, etc. as evidence so long as opposing counsel has access to the video prior to the hearing. As a precaution, do not speak when making a video as it leads to hearsay objections. In any case, it is more effective to have your client narrate the video at the hearing.

ii. Construction cases can benefit from having multiple witnesses. Witness attendance can be expensive, but technology can reduce the costs associated with testimony. Consider using Skype or telephonic testimony to get more witnesses to testify in support of your case. In doing so, it is your responsibility to make sure that the witness has a hard copy of all exhibits. I allow the witnesses to have all exhibits identified in the prehearing statement, so opposing counsel should consider any documents it may need on cross-examination.

iii. Collection cases mean math, and it is easier to hear from the person that did the math in the first place. Consider having the bookkeeper summarize invoices in a spreadsheet exhibit. The bookkeeper can then appear by telephone rather than in person. Be prepared to explain any credits, surcharges, or interest calculations.

iv. Defective work cases can benefit from videos examining the defective work or even comparing it to properly performed work on the same project.

v. Construction cases that involve time and material contracts or quantum meruit theories may require expert witness testimony. In many cases, it would be appropriate to have the expert witness prepare a written statement and then testify by telephone.

<u>Opinions</u>: An arbitration can be a preview to a jury trial should there be an appeal. Consider asking your arbitrator for an opinion. Typically I give a short opinion either orally at the close of the hearing or in writing as I issue my award. If asked, I will give you an opinion on the effectiveness of witnesses or exhibits.

In closing, I am enjoying my experience as an arbitrator and would encourage any attorney with an interest to consider serving as an arbitrator.

WHEN CONTRACTORS ROB PETER TO PAY PAUL: CONSTRUCTION CONTRACTORS BOARD (CCB) ENFORCEMENT ON DISPLAY IN RECENT CASE

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Innovative Design & Construction LLC v. Construction Contractors Board, 278 Or App 448 (May 25, 2016) illustrates the potential reach of the CCB's enforcement power against contractors who use funds received for subcontractor or supplier bills incurred on new construction projects to pay off older debts incurred on earlier unrelated construction projects (termed by some to be the practice of "robbing Peter to pay Paul"). Although the CCB only sought a monetary penalty against Innovative, when reviewed in the light of other statutory enforcement tools at the CCB's disposal, the case suggests the CCB may seek to further extend its enforcement reach in the future to address contractors who "rob Peter to pay Paul."

In the appeals case, the contractor Innovative entered into various contracts with homeowners in 2006, 2007 and 2008. On each project mentioned in the opinion, the contractor failed to pay various subcontractors despite receiving more than enough funds to pay all subcontractors from the owners of the particular projects. After an investigation of the underlying transactions, the CCB issued a notice that proposed to assess a $12,000 penalty against Innovative based on twelve different statutory violations. Innovative requested a hearing. <u>Innovative</u>, 278 Or App 451-452.

The basis of the CCB's enforcement action was ORS 701.098(1)(L)(as renumbered in 2009), which generally requires two elements: That a contractor has "*engaged in conduct as a contractor that is dishonest or fraudulent…that the board finds injurious to the welfare of the public*." To effectuate the statute, the CCB promulgated OAR 812-002-0260, which provides "*dishonest or fraudulent conduct*" includes failing to pay subcontractors and suppliers that performed or supplied a particular project when the contractor has received sufficient funds to pay those bills from the particular project.[1] *Id.* at 453. The administrative law judge made various factual findings after a formal hearing and the CCB issued its final administrative order assessing a $12,000 penalty. *Id*. at 451 n.1.

On appeal, Innovative argued the CCB exceeded its statutory authority by promulgating the portion of OAR 812-002-0260 that provides non-payment of subcontractors when payment has been received is "dishonest or fraudulent." *Id*. at 453. The contractor, who represented itself at the administrative hearing without legal counsel, argued that "he" was honest and simply had cash flow problems. The court held the assertion of honesty at the hearing was insufficient to preserve the error it now raised on appeal. *Innovative*, 278 Or App at 455. The contractor also appealed on the basis that the CCB's interpretation of "injurious to the welfare of the public" under its regulation was erroneous. Again, the court held the contractor failed to preserve the error.

While *Innovative* does not create much law insofar as the appellant's arguments against similar CCB enforcement actions remain undecided, some remarkable insights about the reach of the CCB's enforcement authority can be drawn from the opinion. For example:

No Fraudulent or Dishonest Intent Required? Innovative argued in its brief on appeal that the CCB's regulation OAR 812-002-0260 exceeded the legislature's grant of authority. Specifically, Innovative argued that because the statute uses the terms "*dishonest*" or "*fraud*," the legislature only delegated rule making authority for a regulation that included a "*mens rea*" or intent element. Brief for Appellant at 11-14 (June 14, 2013). Again, the court held Innovative failed to preserve this argument for appeal. However, the CCB's appellate brief defended the lack of a *mens rea* requirement by arguing that fraudulent intent could be inferred from a failure to disburse funds in a different manner than was intended by the payor. Brief for Respondent at 9-11 (Oct. 11, 2013).

No Present Harm Required? Notwithstanding facts in the record that some subcontractors filed liens against some of the projects, the court's opinion suggests the CCB's interpretation of "injurious to the welfare of the public" does not require actual, present harm. Although dicta, the court opinion includes a quote from the administrative law judge's findings that Innovative's business practices pose a risk to "*any potential clients that their payments will be diverted from their own construction projects*" and to "*any subcontractor that it will not be paid for its work on a future project*." Innovative, 278 Or App 456 (Emphasis added).

No Final Adjudication on Debt Required? Apparently none of the subcontractor debt described in *Innovative* had been adjudicated (rather, Innovative simply admitted a certain sum was owed). *Id*. at 452. Under ORS 701.102, the CCB may revoke, suspend or refuse to issue a license if a contractor incurs a "construction debt," which is generally defined as a debt related to construction activities in Oregon that has been reduced to final judgment, award or CCB order (with the possible exception of non-payment of wages). *See* ORS 701.102 and 701.005(4) (definition). The CCB's definition of "dishonest or fraudulent" effectively permits the CCB to assert its authority includes imposition of penalties involving debts that are not "construction debts"

[1] See OAR 812-002-0260: "Dishonest or fraudulent conduct," as used in ORS 701.098(1)(L) and (4)(a)(D) includes, but is not limited to, the following: * * * * (2) Failing to pay monies when due for materials or services rendered in connection with the applicant's or licensee's operations as a contractor when the applicant or licensee has received sufficient funds as payment for the particular construction work project or operation for which the services or materials were rendered or purchased; * * *

under ORS 701.005(4). The CCB likely would argue this interpretation is permissible due to the focus on conduct involving the diversion of funds rather than simple non-payment of debt. *See e.g.* Respondent Brief at 9.

Financial Penalty for Non-Payment of Debts? In *Innovative*, the appellant argued the CCB sought a penalty of $12,000 for twelve violations of ORS 701.102(1)(L), essentially for non-payment of debts. This author found no statute or regulation purporting to impose financial penalties for non-payment of "construction debts" under ORS 701.102. *See* OAR 812-005-0800 (titled "Schedule of Penalties"). To the contrary, a violation of ORS 701.102 (involving non-payment of "*construction debt*") provides three penalties: License suspension, revocation or refusal (ORS 701.102(1)); probation with classes (ORS 701.102(3)); or the requirement of an enhanced licensure bond (OAR 812-003-0175 - Increased Bond, Letter of Credit or Cash Deposit Requirement, Past Unresolved Activity).

Emergency Suspension of License Without Prior Hearing. ORS 701.098(4) provides that upon certain criterion, the CCB administrator may, after making specific findings, "*suspend or refuse to renew a license <u>without hearing</u> in any case where the administrator finds a serious <u>danger</u> to the public welfare*." (*<u>Emphasis added</u>*). The criterion includes the failure to maintain a bond, the failure to maintain insurance, incurring a "*construction debt*," or "*dishonest or fraudulent conduct.*" As noted above, a "*construction debt*" is generally (except possibly in the case of wages) a debt owed pursuant to a final adjudication. ORS 701.005(4). *Innovative* demonstrates that a logical extension of the CCB's OAR 812-002-0260(2) definition of "dishonest or fraudulent conduct" is that the CCB can suspend contractors for non-payment of *alleged* subcontractor debts that have not been proved to be owed. If robbing Peter to pay Paul is dishonest or fraudulent conduct that is a danger to public welfare without actual proof of present harm, what more is needed to be deemed a "*serious*" danger to enable the CCB to issue an emergency license suspension?

In sum, while the *Innovative* case does not create much new law as the key arguments of appellant were not preserved, the case demonstrates the CCB's breadth of enforcement powers and its willingness to push the margins of the statutes in particular instances.

PROTECTIONS AGAINST SUBCONTRACTOR DEFAULTS: PERFORMANCE BONDS VS. SDI

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Among every construction project's worst nightmares is the subcontractor default, where a particular trade subcontractor cannot meet its contractual obligations due to insolvency, mispricing, or other misallocated risks. A subcontractor default poses potentially significant damages to the prime contractor and owner including corrective work, costs of completion, and delay. Two chief options exist to protect against such risks – performance bonds and subcontractor default insurance (SDI)– but choosing one over the other can be complex as each vehicle carries its own unique characteristics and project consequences.

Vehicle Structure and Form. A performance bond is a three-party agreement between the principal, the obligee, and the surety. The surety agrees through the bond to answer for the debt or default of the principal. Any damaged party may make a claim. In contrast, SDI is a two-party agreement between the insured and the insurer in which the insurer undertakes to indemnify the insured against loss as a result of a contingent default. With SDI, only the general contractor may make a claim, not the owner.

History. Suretyship has been around for millennia, with references found in Ancient Greece and the Old Testament. In 1884 the American Surety Company began underwriting construction performance bonds, and in 1894 Congress passed the Heard Act requiring surety bonds on federally funded projects. Conversely, SDI has a much shorter history, first created by Zurich N.A. Insurance Company in 1995 and subsequently offered by several other insurers in 2010.

Intended Use. Performance bonds are required by statute for any federal or state public project in excess of $100,000, and are also used on some private projects. Although courts have imposed insurance-like duties (such as claims-handling procedures) on sureties, bonds are not insurance policies. Typical SDI projects are large, as policies involve annual volume thresholds in the tens of millions of dollars or projects in excess of $100 million. SDI is also generally not allowed on public projects.

Cost and Deductibles. Bond premiums vary but can range from 0.5% to 1.5% of the contract amount with the average above 1%. While there are no deductibles, bonds require an indemnity agreement and collateral, often with personal guarantees. SDI policies do not require collateral. SDI premiums are typically lower and can be 50%-70% the cost of a bond, not counting deductibles and co-pays. This lower cost can provide an advantage in bidding a project. However, many SDI policies carry large deductibles, from $350,000 to $2 million with co-pay sharing at $1 million-$5 million.

Subcontractor Prequalification and Risk Shifting. With a performance bond, the surety remains responsible for screening and prequalifying subcontractors, investigating any default, and responding to complete the contract or make payments. However, the surety also has a self-interest in denying the predicate of a default occurrence. Under SDI, the contractor screens the subcontractors and retains the majority of risk through deductibles and co-payments, which could balloon if multiple defaults occur in the same calendar year. The contractor might also run into difficulty with subcontractors reluctant to share sensitive financial data. Still, the contractor retains control of the completion of the project and can maximize efficiencies to avoid further delays and increased costs.

Damages. Recoverable damages on a performance bond generally cannot exceed the penal sum of the bond, which can pose a problem in projects involving numerous change orders if the bond sum does not include those changes. Typically, delay damages are not recoverable on a bond though courts in Pennsylvania and California have allowed recovery. SDI tends to afford broader recovery for damages, including the cost of completion, losses due to corrections of defective work, indirect losses including possibly liquidated damages, and legal costs.

Legal Precedent. Performance bonds' long history and statutory frameworks provide considerable legal authority that help predict outcomes of disputes under a bond. Conversely, with SDI there is virtually no legal precedent from which to glean interpretation of disputes, with just a dozen or so reported cases, most not interpreting policy language.

Summary. SDI can provide some advantages in the form of lower costs, control over subcontractor selection, and direct management of default situations. However, there are financial risks to the general contractor, who may also face opposition by subcontractors in the prequalification process. The dual insurance relationship is not a clear substitute for the tripartite surety bond setup, and the lack of legal decisions regarding SDIs injects a higher level of uncertainty as to how the policies might be interpreted. Project participants should carefully consider the benefits and risks of all options to protect against defaults prior to commencing their next construction project.

CD Claims from the Perspectives of the Insurer and the Policyholder

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Introduction

This article aims to provide a brief overview of common insurance-coverage issues in construction-defect disputes, from both the policyholder and insurer perspectives. By combining both a primer on Oregon law and where needed the different perspectives of the two sides we hope to provide some guidance to the general practitioner in this complex area. We have not provided case citations in the interest of readability – citations for some of the propositions below can be found in the various OSB insurance law Bar Books.

Hypothetical

Imagine the following: You represent a general contractor involved in both residential and commercial construction. Your client received a statutory "701 notice" from a law firm representing a homeowners' association for a large projects that your client worked on about five years ago. *See* ORS 701.565. The 701 notice alleges that the client is responsible for numerous construction defects at the project. What do you do?

One thing that should be done, of course, is to advise the client to look into what insurance may be available to respond to the 701 notice. So let's assume that your client confirms that they have maintained the required Commercial General Liability (CGL) coverage for the last five years. What do you advise the client to do?

The Initial Notice

There are seldom any downsides to tendering a claim right away - and plenty of potential upsides. A 701 notice will usually include an allegation that the construction defects have resulted in damage to physical property. That is, of course, within the coverage grant of any CGL coverage. The client, you, or the client's insurance broker should therefore tender the 701 notice to the CGL carriers. [NB: If your client is a design professional with "claims-made" coverage, failure to tender any kind of notice of claim may result in coverage problems later on.]

Which insurers should receive notice? Usually the simple answer is: all of them. A CGL policy covers liability resulting from property damage that occurs during the policy year. So, if the alleged property damage is the result of rainwater intrusion, then every policy in effect from when the project was completed to the present is at least theoretically on the "risk," and should be notified.

But, your client asks you, the policy says that the carrier only owes a defense against a "suit" – why would the carrier be interested in a mere letter notice? **From the policyholder perspective,** a 701 notice is a "suit." To put it simply, because most CGL policies define "suit" to include ADR, and a 701 notice is a statutorily required form of pre-suit dispute resolution, which is a form of ADR, each insurance carrier has an obligation to immediately provide a defense, even to a 701 notice. **From the insurer perspective** a 701 notice is not actually a proceeding of any kind where a defense is even necessary. For that reason, some insurers will accept a tender of a 701 notice, and some will not.

Insurer's Initial Response to Claim – Determining the Duty to Defend

Each insurer will analyze the notice in light of its two primary duties – to defend and indemnify. The duty to defend usually involves hiring legal counsel to defend the suit. The duty to indemnify involves paying the amount for which the insured becomes liable for the claim, subject to the conditions and exclusions of the policy.

The duty to defend is broader than the duty to indemnify. An insurer must defend an action against its insured if the claim stated in the notice or complaint could impose liability for conduct covered by the policy: that is, if there is a possibility that the insurer will have a duty to indemnify. In Oregon, the duty-to-defend inquiry is limited to the "4 corners" of the complaint and the insurance policy. That is to say, in Oregon the insurer cannot look beyond the pleadings and the policy and consider extrinsic evidence to assess the duty to defend. (This approach contrasts with Washington law, for example, where an insurer has a duty to examine extrinsic evidence to determine whether a duty to defend exists, although an insurer cannot use extrinsic evidence to decline a defense.)

Insurer Response: Requesting Documents

Generally speaking, a CGL insurer general must indemnify its insured only for liability for damage to other property (that is, to property other than the insured's) caused by the insured's work. The damage must occur during the policy period.

From the insurer perspective, therefore, it is appropriate to respond to a notice and request for defense by requesting documents and information regarding the scope of the insured's work and the dates of construction. The insurer will request copies of the contracts and invoices, and any notices of completion or certificates of occupancy. **From the policyholder's perspective,** because the duty to defend is determined only by comparing the four corners of the policy with the four corners of the notice/complaint, these documents are not relevant to the threshold issue of the duty to defend, although they may be relevant to the insurer's indemnity obligations.

Insurer Response: Examining Language of 701 Notice/Complaint

If the insured's allegedly faulty work was performed before the policy incepted, the insurer will most likely conclude that there is a duty to defend. If the work at issue was performed after the policy expired, the insurer will most likely conclude that there is no basis to defend or indemnify. **From the policyholder perspective,** unless these facts are pled in the 701 notice (or the complaint), the insurer cannot deny a defense based on "extrinsic" facts about when the work was performed.

In recent years, plaintiff's attorneys have gotten wise to the impacts of these exclusions on insurers' decisions on the duty of defend. The more dates that are mentioned in a pleading, the better chance an insurer will determine there is no duty to defend, because there could be no duty to indemnify. Because it is in an owner's interest for there to be insurance coverage for the costs of construction repairs, savvy owner's attorneys include few, if any, dates in their pleadings.

Many commercial general liability policies also include "known loss" and "prior loss" exclusions. The known loss exclusion applies where the insured knew of the loss when applying for the policy but failed to disclose it. The prior loss exclusion applies if the damage began to occur before the policy period. If the pleadings disclose a basis for either exclusion to apply, the claim will likely be denied. If the pleadings do not disclosure facts to support the exclusion, from the policyholder perspective the insurer is not entitled to documentation on the issue before accepting the duty to defend.

Insurer Response – Deny Defense

From the insurer's perspective, denying defense exposes the insurer to certain risks. On the one hand, if the insurer guesses wrong, the insured's remedy is in contract only because Oregon courts have generally refused to recognize a tort of bad faith failure to defend. In other words, even if the insurer is wrong, the insurer's liability will be limited to any sums owed for defense costs, and indemnification for the underlying liability. (This is in contrast to other states, where in some instances the insurer can be exposed to treble damages, punitive damages and liability for a judgment that is in excess of the policy limits.)

On the other hand, an insurer that refuses to defend loses the right to control the handling of the case against the insured. The insured's choice of counsel may or may not have expertise in the subject matter, or may have to take "short cuts" in the defense such as not hiring experts. In the event that the complaint is amended such that the duty to defense is triggered later, the insurer may have to take over a defense that has been incomplete, increasing the insurer's eventual liability.

Of more potential concern to an insurer is that the insured could enter into a stipulated judgment and covenant not to sue with the claimant. Under this scenario, the insured would agree to a money award against it for a stipulated sum, which could be far in excess of an amount the insurer might believe to be an appropriate exposure. The insured would then assign to the claimant the insured's rights against its insurer, in exchange for a covenant by the claimant to limit any recovery from the insurance proceeds and a promise not to seek recovery from the insured's assets.

Such settlements can lead to a host of problems for the insurer. Under a stipulated judgment, a $100,000 battle could lead, for example, to a $1 million dollar problem, if the insured so stipulates. Left unsettled under Oregon law are issues such as whether an insurer is entitled to object to such a settlement under a provision in the policy requiring the insured to obtain an insurer's consent to a settlement. Also unsettled as of this time is whether an insurer has a right to contest the liability issues in the underlying case, and whether any exposure is limited to the policy limits, or in excess of the limits.

From the policyholder's perspective, a denial of defense can be devastating because of the costs of self-funding a defense. It may be prudent to contest the denial in writing and/or enter into discussions with the plaintiff about either filing suit (if the case is just at the 701 notice stage), amending the complaint to allege additional true facts that may trigger coverage, or stipulating to a covenant judgment as laid out above. Policyholder counsel must of course be careful about collateral effects from having an unsatisfied judgment against the client on the books, and about making sure that the covenant truly protects the client in the event that the plaintiff is unable to recover from the insurer.

Insurer Response – Defend Under a Reservation of Rights

Let's suppose that the insurer instead agrees to defend, but only under a reservation of rights to deny indemnity. Typically, the insurer will then appoint counsel. What should the client's lawyer do then?

In Oregon, a reservation-of-rights defense creates a "tripartite" relationship where the defense counsel has two clients, but because of the inherent conflict of interest, the insured is the "main" client, and defense counsel may not jeopardize the insured's coverage interests. Thus, there is a role for personal counsel, in helping defense counsel avoid coverage pitfalls.

As the case progresses the role of personal counsel may involve dealing with "bad" coverage facts. It may be the case that extrinsic evidence (*e.g.*, the insured's invoices) will show that the insured's work was performed after the policy expired. But if the pleading does not mention any dates, the insurer may have a duty to continue to defend, although there may not ultimately be any duty to indemnify. Therefore, personal counsel may be able to convince the carrier to make settlement money available at mediation based on the insurer's anticipated cost of defense going forward.

Mediation – Issues for Insured and Insurer

From the policyholder's perspective an insurer that is defending, whether or not under a reservation of rights, has a fiduciary duty to settle the claim to avoid exposing the insured to liability. This is particularly true where the demand exceeds policy limits or where there are coverage problems. As a practical matter, however, personal counsel's job is to make it easier for the insurer to make the "right" decision about funding a settlement. This requires understanding what the typical insurer needs, and when they need it, to come to mediation equipped with sufficient authority to make that "right" decision.

From the insurer's perspective mediation is (hopefully) the final stage in a rather long process of getting an understanding of the potential liability and any coverage issues, obtaining settlement authority from upper-level supervisors at the insurer, and working out in advance (if possible) any disputes with the insure. The bottom line is that the insurer needs time to prepare for mediation, and needs not to face surprises at mediation. If the insurer is diligent the adjuster will request information well in advance, and will follow up with the insured or its counsel before the mediation to do as much "advance" work as possible.

Conclusion

Insurance coverage is a common, practically omnipresent issue in construction litigation. It adds another set of players to the mix, and a player whose decision-making process can sometimes be challenging for the contractor to understand and contend with. The duty-to-defend and mediation stages of a case are where insurance are often at the fore. Fortunately, Oregon law is fairly well-developed on most issues that come up in construction coverage disputes. We hope that this outline provides some help in understanding the considerations of insurers and policyholders.

NOTE: Prior newsletters are available (in a searchable format) at the Section's website: *www.osbarconstruction.com*.