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TODAY'S E-MAIL IS TOMORROW'S TRIAL EXHIBIT

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The construction industry has embraced the electronic communications revolution. It should come as no surprise that e-mail and other electronic communications are routinely making their way into the courtroom. Attorneys can use your accurate electronic communications record as a sword or a shield. All contractors should implement an electronic communication program as part of their employee training and record-retention programs. Consider the following:

1. E-mail is correspondence. All e-mail should be collected and stored just like letters and faxes. Consider storing e-mail in an electronic folder that can be saved to a disk at the completion of a project. Appoint a person to be responsible for filing e-mail.

2. E-mail should be limited to a single subject. Limiting the subject of an e-mail may limit the number of documents that must be produced in a lawsuit. Limiting the subject of an e-mail also helps you target an appropriate audience and helps avoid confusion. If necessary, send multiple e-mails.

3. E-mail should create a clear record. Always be aware that an e-mail may become an important exhibit. Avoid using alternative colors or "wallpapers" that do not copy well. Do not alter the original e-mail in a reply e-mail. If you are responding to a laundry list of items, such as a punch list, use the "cut and paste" function to recreate the list in your reply. Always proofread your e-mail. Use paragraphs and numbers to make your e-mail easier to read.

4. The attorney-client privilege and work product doctrine. Correspondence between clients and their attorneys may be protected by the attorney-client privilege. E-mail prepared at the direction of the attorney may be protected by the work product doctrine. Opposing counsel cannot access e-mail protected by the privilege or the doctrine as long as both the client and the attorney adhere to certain precautions. Caution clients to be especially careful to protect this type of e-mail by not sharing it with third parties.

5. "Netiquette." E-mail is not a casual conversation. Your communications are for the record and can be used to your disadvantage at trial. Be polite. Use appropriate names and avoid derogatory remarks. Avoid sending an e-mail when you are angry. Often you will know when an e-mail will raise a sensitive subject; have someone proofread the e-mail before sending it.

6. Pressing "delete" does not mean that data has been deleted. Electronic data is saved in several places on your computer. Deleting data does not mean that all copies of the data have been deleted. Computer experts can recover the data stored in your computer.

Attorneys should work to educate their clients about maintaining good e-mail records and observing good e-mail practices. This can be particularly important in these days of Sarbanes-Oxley and other mandatory disclosure obligations.

RISK TRANSFER IN THE AIA CONTRACTS

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Under most circumstances, an insurer has an absolute right to seek subrogation for payments it makes on behalf of an insured. However, this right may be foreclosed by construction contractors using form A201 ("General Conditions") of the American Institute of Architects ("AIA") in conjunction with

AIA general contract forms. [1] The General Conditions contain clauses that transfer the risk of destruction of or damage to the project caused by negligent construction from the contractor to the owner's insurer. The General Conditions also waive subrogation for claims paid by the owner's insurer. Recognizing this risk-shifting scheme and the waiver of subrogation allows counsel for owners, general contractors and subcontractors to facilitate claims processing, avoid litigation, and defend claims when they are brought. This article outlines how the General Conditions accomplish this risk shifting, and discusses the scope of the waiver of subrogation imposed by the contract.

At the outset, it is important to understand why the AIA seeks to shift the risk of property damage to the owner's insurer. Several courts have commented that shifting this risk of loss to the owner's insurer is useful in construction projects because bringing all property damage under one all-risk insurance policy avoids disruption and disputes among the parties, thereby eliminating the need for lawsuits, while at the same time protecting the parties from loss. The result of this risk-shifting scheme is to foreclose the possibility of a subrogation claim brought by an owner or its insurer. Commentators agree that the AIA intended to create this risk-shifting mechanism and foreclose subrogation. Professor Justin Sweet writes:

> [W]hen we look at the AIA documents - all of them - A201, A401 (the subcontract), and B141 (design service contract) reflect a decision by the AIA to eliminate *any* subrogation claims, at least against active participants in the construction process who use AIA documents.

Justin Sweet, Sweet on Construction Law (1997), published by the American Bar Association. (Italics in original).

In another book, Professor Sweet writes:

> The AIA has made a strenuous effort to bar subrogation claims by having participants waive any claims they may have against other participants. . . . The AIA would like the outcome so clear that the party seeking protection from such a claim can receive a summary judgment in its favor.

Justin Sweet, Sweet on Construction Industry Contracts: Major AIA Documents, 2nd Ed. 660 (1992).

The General Conditions of the AIA Contract

Shifting the risk of property damage to the owner's insurer begins by limiting the general contractor's indemnity obligation. Specifically, the general contractor is not required to indemnify the owner for damage to the work caused by the contractor's negligence. Article 3.18.1 states:

> To the fullest extent permitted by law . . . the Contractor shall indemnify and hold harmless the Owner, Architect, Architects' consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including, but not limited to attorneys' fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss or expense is attributable to . . . injury to or destruction of tangible property (**other than the Work itself**) but only if caused by the negligent acts or omissions of the Contractor, a Subcontractor or anyone directly or indirectly employed by them . . . .

Article 3.18.1. (Emphasis added).

The contractor's insurance obligation is limited in a consistent fashion; *i.e.*, the contractor is not required to purchase insurance protecting the owner against damage to the work. Article 11.1.1.[2] Rather, the General Conditions require the owner to purchase all-risk insurance to cover such damage. Article 11.4.1.[3]

1 All citations refer to the 1997 version of the AIA A201 - *General Conditions of the Contract for Construction*.

2 **Article 11.1.1** The Contractor shall purchase . . . such insurance as will protect the Contractor from [the] claims set forth below which may arise out of or result from the Contractor's operations under the Contract, and for which the Contractor may be legally liable:

> (1) claims for damage, **other than to the Work itself**, because of injury to or destruction of tangible property, including loss of use therefrom. (emphasis added)

3 **Article 11.4.1**. Unless otherwise provided, the Owner shall purchase . . . property insurance written on a builder's risk "all-risk" or equivalent policy form in the amount of the initial Contract sum. * * * This insurance shall include interests of the Owner, the Contractor, Subcontractors and Sub-subcontractors in the Project.

The final step in shifting the risk of property damage to the work to the owner's insurer is found in the Waiver of Subrogation provision. This provision provides that the "Owner and the Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and employees each of the other, and (2) the Architect, . . . for damages caused by fire or other perils or other causes of loss to the extent covered by property insurance obtained pursuant to this paragraph . . . or other property insurance applicable to the Work." Article 11.4.7. When read in conjunction with the indemnity and insurance obligation, this waiver provision effectively forecloses subrogation on most property damage claims.

The Scope of the Wavier of Subrogation Provision

The Oregon Supreme Court recognized that the indemnity and insurance provisions reflect a reasoned decision on the part of the contracting parties to shift the risk of injury to or destruction of the work to the owner's insurance. *Orth v. Commerce and Industry Ins. Co*., 254 Or 226, 232, 458 P2d 926 (1969). In *Orth*, an insurer sued a contractor and subcontractors for negligent construction after paying the insured's property claim. The court held that

> [t]he purpose of the [owners'] insurance policy was to protect the owner and the various contractors until the entire project was completed. The waivers of liability were intended to release the contractors from liability to the owner for insured losses during the entire period of construction. . . . The total effect of all the contracts was to distribute the risks incidental to construction to an insurance carrier . . . .

Id., 254 Or at 232-233. The court applied the waiver of subrogation provision to bar the insurer's claim. Courts in other jurisdictions have similarly interpreted the insurance, indemnity, and waiver of subrogation provisions.[4]

In the face of these arguments, the challenge for a party seeking subrogation is to fashion an argument that the claim falls outside the scope of the waiver. For example, the plaintiff may argue that the parties never intended that the owner's insurance would cover the damage giving rise to the claim. This may be a forceful argument if the damage arises from causes not generally covered by property liability or builder's risk insurance, like water damage or mold. However, the requirement that the owner provide all-risk insurance undercuts this argument. All-risk insurance ordinarily covers every loss that may happen, except those caused by fraudulent acts of the insured. This includes perils typically excluded from property damage insurance policies.[5]

An interesting question arises if the owner has failed to obtain all-risk insurance. In that case, the owner may argue that the insurance it has obtained, in the aggregate, provides coverage equivalent to an all-risk policy. Although this argument seeks to circumvent the express terms of the General Conditions and should be unsuccessful, it raises the issue of whether the waiver of subrogation applies to bar subrogation by insurers whose policies were not purchased pursuant to the contract.

The answer to this question largely depends on the meaning of the phrase ". . . other property insurance applicable to the Work" as used in Article 11.4.7 of the General Conditions. If the phrase means that the waiver provision bars subrogation by any insurer that covers damage to "the Work," then subrogation is barred regardless of the source of the insurance proceeds; i.e., a CGL policy, or a builder's risk policy. If the waiver applies only to the coverage afforded by a policy obtained pursuant to the contract, then the type of damage sustained will determine whether the waiver applies.

No court has addressed this question directly. However, in *Asic II Limited v. Stonhard, Inc.*, 63 FSupp2d 85 (D Me, 1999), the reinsurer of a property

4 *See Richmond Steel, Inc. v. Legal and General Assurance Society JTD*, 821 FSupp 793, 800-801 (D. Puerto Rico, 1993), *citing*, *Fidelity and Guaranty Co. v. Farrar's Plumbing and Heating Co.*, 158 Ariz 354, 762 P2d 641 (1988); and *Intergovernmental Risk Management v. O'Donnell, Wickland, Pigozzi & Peterson Architects, Inc.*, 295 IllApp3d 784, 692 NE2d 739, 743 (1998).

5 "An 'all-risk' policy is a special type of coverage extending to risks not usually covered under other insurance, and recovery is allowed thereunder for all losses, other than those resulting from a willful or fraudulent act of the insured, unless the policy contains a specific provision expressly excluding a particular loss from coverage." *Steamboat Development Corp. v. Bacjac Industries, Inc.*, 701 P2d 127 (Colo. 1985); *see also*, *Haemonetics Corp. v. Brophy & Phillips Co. Inc.*, 23 MassAppCt 254, 258, 501 NE2d 524 (1986).

insurer sought subrogation from a contractor for property damage caused by fire. The court held that the waiver of subrogation barred the claim:

> All-risk property insurance covers premises or property locations against fire or other perils. Thus, the only logical interpretation is that "other property insurance application to the Work" refers to insurance applicable to the location of the work or the building containing the work since that is the kind of insurance contemplated by [the waiver provision] in the first instance. The court finds that the waiver clause applies; [Owner] and [Contractor] unequivocally waived "all rights against each other" for damages caused by fire to the extent covered by property insurance. The damages from fire at [the Work] were covered by the IRI policy; hence [the reinsurer's] claims are barred.

Id. at 93.

Similarly, in *Intergovernmental Risk v. O'Donnell, Wicklund, Pigozzi & Peterson Architects, Inc.*, 295 IllApp3d 784, 692 NE2d 739, 743 (1998) a contractor's insurer seeking subrogation for a claim paid to the owner argued that the waiver of subrogation provision did not apply because its policy was a general liability policy. The court rejected this argument:

> The issue is not whether the policies are called "all-risk" or "general liability" policies but whether those policies cover the risks and losses delineated in the construction agreements between the [owner] and the architect and the contractor. The Travelers policy which was attached to plaintiffs' memorandum in support of their response to defendant's motion to dismiss, shows that regardless of its classification, that policy qualified as "other property insurance applicable to the Work."

692 NE2d at 747-748.

Several courts addressing previous versions of the AIA contract documents have applied the waiver to bar subrogation by insurers and owners whose policies were not obtained pursuant to the General Contract, but which, nevertheless, had covered the damage.[6] These cases lend support to the argument that the waiver provision bars subrogation regardless of the source of the insurance proceeds.

The waiver of subrogation provision also protects subcontractors facing claims from either the owner or the general contractor. This conclusion arises from the terms of the contract itself. The General Conditions provide that subcontractors are bound by the terms of the Contract Documents:

> [T]he Contractor shall require each Subcontractor, to the extent of the Work to be performed by the Subcontractor, to be bound by the Contractor by terms of the Contract Documents. . . . Each subcontract agreement shall preserve and protect the rights of the Owner and the Architect under the Contract Documents with respect to the Work to be performed by the subcontractor . . . and shall allow to the Subcontractor . . . the benefit of all rights, remedies, and redress against the Contractor that the Contractor, by the Contract Documents, has against the Owner.

Article 5.3.1.

Additionally, the Owner's obligation under the Contract is to obtain insurance that includes the interests of the Owner, the Contractor, Subcontractors and Sub-Subcontractors in the Work. Article 11.4.1. The text of the waiver provision also states that it applies to subcontractors: "The Owner and the Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and employees each of the other . . . ." Article 11.4.7.

Several courts have held that the waiver provision also bars subrogation from a subcontractor. In *Commerce and Industry Ins. Co. v. Orth, supra*, the court held that it could assume that subcontractors relied on the waiver of subrogation provision in the General Contract because the provision existed before they began performance. In *Butler v. Mitchell-Hugeback, Inc.*, 895 SW2d 15 (Mo 1995), the Missouri Supreme Court held that, even though the architect was not a party to the general contract between the owner and general contractor, he was a "third-party beneficiary of that contract" and was entitled to the benefit of the waiver. In *United States Fidelity and Guaranty Co. v. Farrar's Plumbing and Heating Co.*, 158 Ariz 354, 762 P2d 641 (1988), the Arizona Court of Appeals held that the defendant subcontractor was an intended beneficiary of the waiver of subrogation clauses. *See also*, *Indiana Insurance Co. v. Erhlich*, 880 FSupp 513, 520 (WD

6 *See Lloyds Underwriters v. Craig and Rush, Inc.*, 26 CalApp4th 1194, 1200, 23 CalRptr2d 144 (1994); and *Trinity Universal Ins. Co. v. Bill Cox Construction, Inc.*, 75 SW3d 6, 13 (Tex 2001).

Mich 1994) (holding that a subcontractor is a third-party beneficiary of the prime contract).

Still, other courts classify subcontractors as "co-insureds." In *Town of Silverton v. Phoenix Heat Source System, Inc.*, 948 P2d 9, 12 (Colo 1997), the court held that the waiver of subrogation provisions "placed the [subcontractor] defendants essentially in the position of co-insureds on the town's property insurance policy . . . ." In *South Tippecanoe School Building Corp. v. Shambaugh & Sons, Inc.*, 182 Ind App 350, 360, 395 NE2d 320 (1979), the court found that the General Conditions evinced "an intent to place any risk of loss on the Work on insurance; the [subcontractor] [d]efendants are intended 'insureds' under the builder's risk policy; and the waiver provisions are fully applicable here." *See also*, *Olinkraft, Inc. v. Anco Insulation, Inc.*, 376 So2d 1301 (LaApp 1979); *Factory Ins. Ass'n v. Donco Corp.*, 496 SW2d 331 (Mo 1973); *Board of Education v. Hales*, 566 P2d 1246 (Ut 1977).

Whether considered third-party beneficiaries or "co-insureds," the result is the same: subcontractors are protected by the waiver provision in the General Conditions.

A more challenging question arises if the subcontract is drafted by the general contractor, and not by the AIA. Whether the waiver extends to such a subcontract may depend on the strength of any integration clause contained therein, or, alternatively, on the application of the parol evidence rule. An analysis of those issues is beyond the scope of this article, however, it is significant that none of the courts which extended the protections of the waiver to subcontractors rely on an analysis of the subcontract to arrive at their conclusion. For example, in *Temple Eastex, Inc. v. Old Orchard Creek Partners, Ltd.*, 848 SW2d 724, 730 (Tex 1992), the court focused on the General Conditions, holding that:

> [T]he inclusion of the word "sub-subcontractor" in the waiver clause indicates that a considerable depth of parties was contemplated and that the waiver was not meant to be limited only to those who contracted directly with the prime contractor. The language "*The Owner and Contractor waive all rights against each other and the Sub-contractors, Sub-subcontractors, agents and employees each of the other . . .* ," in section 11.3.6 of the contract reveals [the Owner's] and [the Contractor's] intent that the waiver provision extend to subcontractors. Because [the subcontractor] is benefited by the waiver provision, [the subcontractor] is a third-party beneficiary of the construction contract. As a third-party beneficiary, [the subcontractor] is entitled to rely upon and to enforce all of the contract's provisions.

(Italics in original).

In cases where the property damage is not discovered until construction is complete and a certificate of completion has been filed, a party seeking subrogation might argue that the waiver of subrogation does not apply because the damage occurred after the completion of construction. This argument turns on whether the insurance obtained by the owner pays the claim. If so, then the waiver provision should bar a subsequent subrogation claim. This is because the General Conditions provide that "if after final payment property insurance is to be provided on the completed Project through a policy or policies other than those insuring the Project during the construction period, the Owner shall waive all rights in accordance with the terms of Subparagraph 11.4.7 for damages caused by fire or other perils covered by this separate property insurance." Article 11.4.5. Thus, the waiver applies to any additional insurance provided by the owner, even if not obtained pursuant to the General Conditions.

The Georgia Court of Appeals interpreted the previous version of Article 11.4.5 in a case brought by a property owner's insurer against a contractor after a fire damaged "the Work" a year after construction was complete. The court affirmed summary judgment for the contractor, holding that the waiver applied after construction was complete, and after final payment was made. *Colonial Properties Realty Limited Partnership v. Lowder Construction Co., Inc*., 256 GaApp 106, 567 SE2d 389 (2002).

Conclusion

The limited scope of the indemnity and insurance provisions of the General Conditions, coupled with the broad application of the waiver of subrogation, will, in most instances, foreclose an owner's or insurer's subrogation claim for damage to the project arising from negligent construction. Counsel for owners, general contractors and subcontractors should be aware of how the risk-shifting scheme and waiver of subrogation provision within the General Conditions apply in the event such claims arise.

SUMMARY OF CHANGES IN OREGON'S PUBLIC CONTRACTING CODE: HB 2341 (2003 OR LAWS, CH 794)

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Introduction. As of March 1, 2005, the operative date of HB 2341, existing public contracting laws under ORS Ch 279 are repealed (with the exception of statutes on products of disabled individuals) and replaced with three new chapters which together will constitute the new Oregon Public Contracting Code. Those new chapters will be ORS Ch 279A on General Provisions (affecting the entire Code), ORS Ch 279B on Public Procurements (for general goods and services) and ORS Ch 279C on Public Improvements and Related Contracts (for construction, architectural, engineering and related services). The complete separation of the latter two chapters was intentional, allowing the development of innovative contracting techniques for general procurements, while preserving this state's historic requirements for public improvements.

Section 334 provides that contracting rules and exemptions adopted under statutes to be repealed will also expire on March 1, 2005. Notwithstanding that general operative date, HB 2341 took effect immediately upon passage to provide for rule making and other preliminary activities under Section 335, which also requires that the Attorney General adopt new model public contract rules implementing the Code on or before September 1, 2004 (with an effective date of March 1, 2005).

ORS Ch 279A. This chapter sets forth the overarching provisions for the entire Public Contracting Code, including definitions and general policy statements. The organization and applicability of various parts of the Code are identified, including types of contracting, acquisitions and organizations that are not made subject to the Code. The procurement and rule making authority of state agencies is set out specifically, and local contracting agencies are required to exercise their contracting authority in accordance with the Code. Delegation authority and federal override provisions (in the case of federal funding) are also specified.

Provisions are centralized for the treatment of minority, women and emerging small businesses, including subcontracting requirements and remedies for discrimination. A three year statute of limitations is established for a contracting agency to allege discrimination in subcontracting. Current statutes on contract preferences (including Oregon goods and services, nonresident bidders and recycled materials) have also been centralized.

Statutes applicable only to state agencies and state surplus property are grouped within ORS Ch 279A, as are provisions relating to personal services, intergovernmental agreements and a new comprehensive framework for cooperative procurement.

ORS Ch 279B. Greater procurement flexibility is allowed in this chapter than under current law for the general procurement of "goods and services" (other than public improvements and related services addressed in ORS Ch 279C), based upon concepts derived from the ABA Model Procurement Code. Special treatment is provided for personal service contracts as they are identified by local agencies. Contracting agencies may select from two primary methods of procurement; competitive sealed bids or competitive sealed proposals. ORS Ch 279B then provides the procedural checklist type requirements for each of those source selection methods. Additionally, five other contracting methods are identified:

(1) Small Procurements. Procedures are highly informal for procurements with a value of under $5,000.

(2) Intermediate Procurements. Three competitive quotes are required for these informal procurements, up to $150,000 in value.

(3) Sole Source Procurements. Written findings are required that the goods or services are available from only one source.

(4) Emergency Procurements. The head of a contracting agency, or designee, may authorize a defined "emergency" procurement after documentation.

(5) Special Procurements. These provisions are similar to the formal exemption requirements under the current ORS 279.015(2).

ORS Ch 279B contains its own administrative provisions, including cancellation, offeror responsibility, prequalification and debarment, notice of intent to award, use of price agreements and matters pertaining to specifications.

New legal remedies provisions are set forth in ORS Ch 279B for procurement of goods and services, in which a protest procedure is established at the contracting agency level. Exhaustion of administration remedies is required prior to litigation, and courts are directed to give deference to contracting agency determinations of fact. Questions of law continue to be determined by the courts. These new provisions do not apply to public improvement contracting under ORS Ch 279C, in which the current legal remedies under ORS 279.067 remain in place (litigation without exhaustion of administrative remedies or a required protest procedure).

ORS Ch 279C. Of the three new chapters within the Public Contracting Code, this chapter most closely resembles existing ORS Ch 279. Current statutes were reorganized and updated, but substantive changes required complete consensus of an industry wide forum which then reported recommendations for HB 2341 to the overall Public Contracting Law Revision Work Group established by HR 1 during the 2001 Regular Session. As a result, unlike ORS Ch 279A and 279B, ORS Ch 279C does not constitute a wholesale change from existing law. Competitive bidding was retained as the norm for public improvements, and no substantive changes were made to statutes on hours of labor, prevailing wage rates, payment and interest, retainage, actions against payment bonds, first-tier subcontractor disclosure, prequalification, disqualification or legal remedies. However, there were six areas of substantive change:

(1) Architects, Engineering, Land Surveying, and Related Services. Definitions and procedural requirements were reorganized and centralized within a new subdivision. Related services were defined and procedural provisions identified. Qualifications based selection is required for state agencies, or where state funding is utilized, and otherwise that process is merely allowed for local agencies.

(2) Bidding Exceptions and Exemptions. While competitive bidding is retained as the norm for public improvement contracts, an exception is allowed for intermediate level procurements (see below), emergency contracting procedures are clarified, and class exemptions are specifically authorized. ODOT's exemption authority, obtained during a 2002 Special Session, also now sunsets on July 1, 2012.

(3) Performance and Payment Bonds. Specifically requires a 100% performance bond as well as a 100% payment bond, rather than one combined bond, and clarifies the purpose of each. HB 2341 requires bonds from a surety company with a state certificate of authority, and clarifies that the right of action on the payment bond also applies in the case of competitive proposals.

(4) Competitive Proposals. These new provisions do not authorize the use of competitive proposals for public improvement contracts, but set out a procedural framework where they are authorized. Bidding statutes applicable to competitive proposals are identified, as well as inapplicable statutes. Requirements for Requests for Proposals and the selection process are also set forth.

(5) Competitive Quotes. These new provisions do not authorize the use of competitive quotes for intermediate level procurements, but set out a procedural framework. Three informal quotes are required, with award made to the lowest priced or a written record of the alternative basis of award. The thresholds, under Section 103, are $100,000 or $50,000 for a contract for a highway, bridge or other transportation project.

(6) Construction Contract that are not Public Improvements. Under these new provisions, such contracts (including minor alterations, ordinary repair or maintenance of a public improvement) are to be procured as ordinary goods and services under ORS Ch 279B. Other requirements of ORS Ch 279C, such as prevailing wage rates, may apply. Provisions are also aligned for projects in which no funds of the agency are utilized.

NEW "PROMPT PAY" LEGISLATION

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The Oregon legislature gave contractors a hand by passing SB 906. Sections 54 to 60 of this bill set forth new requirements for prompt payment to contractors under certain construction contracts. Original contractors, subcontractors, and material suppliers will be entitled to interest on unpaid balances. Prevailing parties can get costs and attorneys' fees in actions to recover interest and unpaid balances. Original contractors and sub-contractors have the right to suspend performance, or even terminate contracts, if they are not promptly paid for their work.

SB 906 applies to written or oral contracts for all aspects of construction, including excavation, demolition, new structural construction, and the alteration or repair of existing construction. It does not apply to contracts for the construction of structures subject to the Low Rise Residential Dwelling Code (formerly the One And Two Family Dwelling Code), certain low-income multiple-unit dwellings, and public contracts. SB 906 applies to contracts for which the plans and specifications are first published on or after January 1, 2004.

This new legislation treats original contractors differently than subcontractors and material suppliers. Original contractors must submit billings or estimates to owners on a 30-day billing cycle unless the plans and specifications include an alternate billing cycle or extended payment provision. Owners must make progress payments to original contractors within 14 days of the submission of billings or estimates, but only to the extent that the billings or estimates are certified. Owners must pay original contractors within seven days of completion and approval of all work. The payment provisions of SB 906 do not apply to contracts anticipated to last less than 60 days, though the parties have the option of voluntarily adopting the provisions.

Owners have defenses. Billings or estimates are not considered "certified" just because an original contractor has submitted them. An owner must promptly review the billings and estimates for approval. Billings or estimates will be considered certified on the tenth day after an owner receives them unless the owner issues a written statement detailing specific items that are not approved.

An owner may decline to approve billings or estimates for the following reasons: 1) unsatisfactory work progress; 2) defective work or materials; 3) disputed work or materials; 4) breach of contract; 5) third-party claims; 6) failure of the original contractor or a subcontractor to pay subcontractors or material suppliers; 7) damage to the owner; 8) reasonable evidence that the construction contract cannot be completed for the unpaid balance of the construction contract sum; or 9) other items as allowed under the contract. An owner should carefully review the law and consult legal counsel before refusing to approve billings or estimates.

Similar rules require original contractors (or in some instances, subcontractors) to make prompt payment to subcontractors and material suppliers. Subcontractors or material suppliers are entitled to payment if they have properly performed under the contract and submit bills or invoices for their work. An original contractor (or in some instances, subcontractor) must pay a subcontractor or material supplier within seven days of its own receipt of a payment that includes payment for the work of the subcontractor or material supplier. The sub-contractor or material supplier may be required to provide a lien waiver.

Original contractors (or in some instances, subcontractors) also have defenses. They can refuse to request payment for the work of a subcontractor or material supplier if it has withheld payment from the subcontractor or material supplier. An original contractor (or in some instances, a subcontractor) can withhold payment from a subcontractor or material supplier for the following reasons: 1) unsatisfactory work progress; 2) defective work or materials; 3) disputed work or materials; 4) breach of contract; 5) certain third-party claims; 6) failure of the subcontractor to pay other subcontractors or material suppliers; 7) damage to the owner, original contractor, or subcontractor; 8) reasonable evidence that the construction contract cannot be completed for the unpaid balance of the construction contract sum; 9) a reasonable amount for retainage; or 10) other items allowed under the contract or purchase order.

Failure to make prompt payment will result in penalties. An owner that fails to make prompt payment must pay the original contractor interest on the outstanding balance at the rate of 1.5 percent per month or at a higher rate if allowed by the contract. Likewise, an original contractor (or in some instances, a subcontractor) that fails to make prompt payment must pay a subcontractor or material supplier interest on the outstanding balance at the rate of 1.5 percent per month or at a higher rate if allowed by the contract. The prevailing party in any action to recover payments or interest is entitled to recover its costs and attorneys' fees.

Perhaps the most severe penalty is the right of an unpaid original contractor or subcontractor to suspend performance under a contract, or even terminate the contract, if not promptly paid. Original contractors must provide seven days' written notice before suspending performance; subcontractors must provide three days' written notice before suspending performance. Original contractors or subcontractors can terminate the contracts once their work has been suspended for longer than 30 days.

SB 906 has some flexibility. For example, owners have the ability to use alternate billing cycles,

extended payment provisions, or extended certification period provisions by giving certain notices within the contract. Also, owners and original contractors can agree to change the certification dates and payment dates; however, they cannot make such an agreement without the written consent of any subcontractor or material supplier that has submitted written pricing information to the original contractor.

SB 906 is rigid in other respects. The following contract clauses are void: 1) any clause preventing a party from suspending or terminating its performance if another party fails to make prompt payment under the contract; 2) any clause extending a notice period associated with suspending performance under the contract; 3) any clause altering the right of any original contractor, subcontractor, or material supplier to receive prompt and timely progress payments; 4) any clause making the contract subject to the laws of any state other than Oregon; and 5) any clause requiring disputes to be litigated in a state other than Oregon.

Contractors should note that the failure to reasonably account for construction contract payments can result in disciplinary action by the Construction Contractors Board.

Finally, all notices under this new law must be either personal delivery, certified mail return receipt requested or any other method that allows independent third-party verification.

NEW "RIGHT TO CURE" LEGISLATION

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The 2003 Oregon Legislature has adopted new "Right to Cure" statutes with passage of SB 909. Other states, notably Washington,[1] have passed similar legislation in recent years. The basic concept of this new law is that construction contractors, subcontractors and suppliers (referred to generically in this article as "contractors") now have a statutory right to inspect and offer to cure alleged construction defects on residential projects.

As with many statutes, the definitions are very much the place to start one's examination of these new statutes. For example, a construction "defect" can include any "deficiency, inadequacy or insufficiency arising out of or relating to the construction, alteration or repair of a residence" and can include claims relating to a "system, component or material incorporated" into the residence. The term "residence" is generally defined in ORS 701.005 but also includes common elements in condominiums (ORS 100.005) and common properties in planned communities (ORS 94.550).

The basic rule is that an owner (also a defined term) cannot compel arbitration or commence litigation against a contractor without first giving the contractor a written "notice of defect." If an owner commences arbitration or litigation without complying with these new requirements, a defendant contractor can obtain dismissal (without prejudice) of the arbitration or litigation. These new statutes do not apply to claims filed through the Construction Contractors Board or the Landscape Contractors Board. [2]

The owner's notice of defect must include certain information, including what remediation the owner believes may be necessary, and must include copies of any supporting documents or reports. Like all notices under this new legislation, it must be sent via registered (not certified) mail, return receipt requested.

A contractor has 14 days from its receipt of one of these notices to make a written request to conduct a visual examination of the residence. If the contractor wants a full inspection of the residence (including testing), he must give the owner a written request within 14 days of the date of the visual examination.

If the contractor wants to bring in other parties such as subcontractors or suppliers, the contractor must give them a "secondary notice" within 14 days of the date when the contractor receives its initial notice from the owner. These "secondary" parties also have a right to request a visual examination and/or a full inspection. The initial contractor is obligated to coordinate all of these examinations and inspections with the owner.

[1] Washington adopted Chapter 64.50 RCW in 2002.

[2] This, then, leads to the question of whether, during the time deadlines for filing CCB or LCB claims, this new statute has no real force. This is particularly an issue now that the CCB allows a claimant to file a CCB claim and then also file litigation, with the CCB claim merely being placed into "suspended processing."

After completing its examination and/or testing, the contractor must give the owner a written response. The deadline for doing so is 90 days from the date the contractor received its initial notice. This written response must either acknowledge or deny the defects, or describe how the inspection resulted in a different description of the defect. The response must include copies of any supporting reports or documents. The response must also include an offer to remediate, an offer to pay monetary damages or a denial of responsibility.

If the owner accepts the offer to repair or pay damages, then the allegations concerning those defects are fully satisfied. If the contractor fails to perform the repair work or the owner rejects the offer, then the owner can proceed with its arbitration or litigation claims. Notices of defects and contractors' requests for inspections (and their supporting documents) generally are admissible in such actions. A contractor's rejected settlement offers (and the owner's response) generally are not admissible except for purposes of proving an owner's right to commence arbitration or litigation.

This new legislation also affects statutes of limitation. If an owner sends a notice of defect within the normal litigation statute of limitation, the statutory deadline is extended for (a) 120 days after the contractor gives its written response that denies responsibility for the alleged defects; (b) 120 days after the owner rejects the contractor's offer to repair or pay monetary damages; or (c) 30 days after the contractor fails to meet its agreed-upon deadline to complete repairs or pay damages. For statute of limitation purposes, the contractor's remediation efforts do not constitute new performance and, for ORS 12.135 statute of repose purposes, the remediation efforts relate back to the original date of substantial completion. Thus, the original date of substantial completion remains the "trigger date" for ORS 12.135(1)'s statute of ultimate repose.

Contractors also have a new obligation of giving residential owners a notice of their rights and obligations under this bill. This notice can be given along with the Consumer Notification form or as part of the construction contract. The bill sets out the form of this new notice.

SB 909 did not include an "emergency" clause. Therefore, it is effective as of January 1, 2004. The bill does not mention whether it applies to construction projects that commence after that date or to claims that are asserted after that date or any other limitation.

SUMMARY OF RELEVANT 2003 LEGISLATION

Bill Boyd
Oregon Construction Contractors Board
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A. Contractors and Construction Contracts

1. Claims Against Contractors; SB 909; 2003 Or Laws Ch. 660

See prior article for summary.

2. Prompt Payment; SB 906 (§§54-60); 2003 Or Laws Ch. 675

See prior article for summary.

3. "Unlicensed" Contractor Claims; SB 906 (§71); 2003 Or Laws Ch. 675

SB 906 makes a substantial revision to ORS 701.065. Now, contractors with CCB license defects can seek administrative or civil remedies against construction contractors, construction suppliers, architects or engineers if the claim arises out of defects, deficiencies or inadequate performance of the work or products provided. The prior version of ORS 701.065 provided that contractors who were not properly licensed were essentially barred from any administrative or civil remedies. These provisions of this bill will become operative on October 1, 2003.

4. Contractor Licensing; HB 2564; 2003 Or Laws Ch. 136

The Department of Consumer and Business Services (the location of the Building Codes Division) is now mandated to establish a system whereby a contractor who has two or more licenses issued by the license can make a single combined license. This bill applies only to licenses issued through the Electrical and Elevator Board, the Board of Boiler Rules and the State Plumbing Board (all of which are part of the Building Codes Division). It does not apply to licenses issued through the Construction Contractors Board.

5. Building Code Changes; SB 906 (§§1-53); 2003 Or Laws Ch. 675

The One And Two Family Dwelling Code is now known as the Low-Rise Residential Dwelling Code. There are two new boards with the state Building Codes Division: the Residential Structures Board and the Mechanical Board. The existing Building Codes Structures Board is changed from 15 to 9 members and the types of required parties on this board have been changed. This bill was declared an "emergency" and became effective as of August 8, 2003.

6. Building Plan Review; SB 711; 2003 Or Laws Ch. 367

This bill creates a new ability for licensed engineers and architects who prepare construction plans for one and two family dwellings to avoid plan review by the local building official. The engineer or architect must be certified by the Building Codes Division as a one and two family dwelling plans examiner and the building must be of conventional light frame construction.

The bill also creates new authority for the Building Codes Division to allow local jurisdictions to make electrical and plumbing code plan review mandatory only for complex structures (a term that is not defined by the statutes).

Also, the bill allows the Building Codes Division to adopt rules "necessary to interpret, harmonize, streamline, adjust, administer or enforce the state building code" in order to avoid language that is "unclear, duplicative or in conflict with another or when the code does not adequately address a project of a unique type or scope." The Department Director must report to the Legislature no later than January 30, 2005 as to any rules adopted in this regard.

7. Electronic Permits; SB 713; 2003 Or Laws Ch. 336

This bill allows the Building Codes Division to study the feasibility of a database that would allow electronic submission of permit applications, issuance of minor labor and other appropriate permits, and scheduling for inspections (and tracking of corrections and approvals). The Department Director must report to the Legislature no later than January 30, 2005 as to the implementation of this program. The bill also creates a "sunset" date of January 2, 2006, when the bill will automatically be repealed.

8. Minor & Alternative Permits; SB 714; 2003 Or Laws Ch. 368

This bill takes a Portland area program and applies it statewide. Under this program, the Building Codes Division (and local municipalities) may allow special programs for permitting and inspecting minor construction work. Also, the program allows alternative permit and inspection services for commercial, manufacturing, industrial and institutional facilities (unless the construction work involves life-safety work).

9. Essential Projects; SB 715; 2003 Or Laws Ch. 369

This bill is intended to allow "fast track" approval for construction of "essential projects." These projects are defined as: (1) State owned and operated developments; (2) Developments essential to the state's economic well-being as designated by the Economic and Community Development Department; (3) Projects over 100,000 square feet and in industrial areas listed as ready for development by the Economic and Community Development Department; and (4) Projects over 100,000 square feet and in the "traded sector" (a term defined by ORS 285A.010).

Permit applicants can request that the Building Codes Division administer and enforce the building codes for the project, including plan review and permit issuance. If the Building Codes Division feels that the local building jurisdiction has inadequate resources, the State can undertake all necessary actions on its own.

10. Construction Contracts; SB 906 (§58); 2003 Or Laws Ch. 675

The 2001 Legislature adopted HB 2414 (ORS 81.100 et al) that limited the effectiveness of non-Oregon choice of law provisions in construction agreements. 2003 SB 906 re-addresses and expands on that issue.

Now, construction contracts in Oregon may not include an out-of-state choice of law provision and also may not include an out-of-state forum selection clause. Any such provisions are deemed void and unenforceable. The bill provides that these changes apply to contracts for which the plans were published after January 1, 2004.

11. Electrical Products; HB 2717; 2003 Or Laws Ch. 299

This bill makes revisions to the Oregon Electric Safety Law concerning industrial electrical equipment that reduces the process of insuring that equipment. "Industrial electrical equipment" means electrical devices that are used in industry or government. This bill was declared an "emergency" and became effective as of June 11, 2003.

12. Wells; HB 2210; 2003 Or Laws Ch. 144

This increases the bond or letter of credit from $4,000 to $10,000 that must be posted by anyone who offers services to construct, alter, abandon or convert wells. Also, in order to obtain a permit to work on wells, the applicant must post a bond or letter of credit in the amount of $5,000, an increase from the prior limit of $2,000.

13. Landscape Contractors; SB 919; 2003 Or Laws Ch. 659

This bill clarifies the existing prohibition on using the word "landscape" in a business name without being licensed through the Landscape Contractors Board ("LCB"). Now, an unlicensed person or entity may not use the words "landscape contractor," "landscape gardener" or "landscaper" or any other use of the word "landscape" unless the person or entity is licensed through the LCB. The prohibition includes the use of business cards, signs or other advertising methods. The only exception continues to be for "landscape maintenance" businesses whose name does not include any other connotation.

B. <u>Construction Contractors Board ("CCB")</u>

1. CCB Notices & Fees; HB 2233; 2003 Or Laws Ch. 294

As a new requirement, parties wishing to file claims through the CCB must first send a notice to the contractor. The notice must be sent certified mail and must be sent at least 30 days prior to filing the claim. If the time period for filing a CCB claim is within 45 days of expiring, the claim filing deadline is extended until 60 days after the notice is mailed.

The CCB now has an increased ability to impose a fee for filing a CCB claim. The amount of the fee may not exceed the filing fee for a circuit court lawsuit. The CCB may charge a different fee for residential versus commercial claims. Upon application and showing of need, the CCB may waive this filing fee.

On a procedural note, there is a small change in the deadline for filing a claim concerning a large commercial structure. Previously, ORS 701.046 provided that the claimant could deliver a copy of the complaint to the CCB and the contractor's surety no later than the earlier of 90 days after filing the lawsuit or 14 days before the first day of trial. Now, the deadline is the earlier of those two deadlines or 30 days prior to the court issuing a judgment. This provides for claims where the plaintiff seeks a default judgment less than 90 days after filing the lawsuit.

2. Contractor Insurance; SB 943; 2003 Or Laws Ch _____

This bill gives the CCB authority to adopt rules allowing an alternative to the insurance requirement for licensed construction contractors. Instead of providing proof of the traditional insurance coverage (liability, personal injury and property damage), contractors can provide an "alternative form of security" in a form yet to be determined. The legislature did not specify what would constitute an "alternative form of security," but it did require that it provide protection to the public equivalent to an insurance policy.

The CCB will form a work group to address the relevant issues. While this bill was declared an "emergency" and became effective upon its passage (August 25, 2003), it will likely take some time for the CCB to determine whether there is any acceptable "alternative form of security."

3. CCB Licensing #1; SB 575; 2003 Or Laws Ch 329

The list of parties exempt from CCB licensing (found in ORS 701.010) is expanded to include businesses that supply personnel to licensed contractors. In order to meet this exemption, the personnel must be performing construction work under the direction and supervision of the licensed contractor.

4. CCB Licensing #2; HB 3218; 2003 Or Laws Ch 285

The list of parties exempt from CCB licensing (found in ORS 701.010) is expanded to include qualified intermediaries in a Section 1031 tax-free property exchange. The qualified intermediary must not perform any construction activities in order to meet this exemption.

5. Developer CCB Licensing; SB 906 (§§68-76); 2003 Or Laws Ch. 675

The CCB must institute a new license class for contractors who are licensed developers. "Licensed developers" are defined as contractors who own real property and arrange for construction work by licensed contractors who have sole responsibility for all phases of construction. The licensed developer itself may not perform any on-site construction work. Licensed developers are exempt from the education and examination requirement imposed on licensed contractors.

This bill then revises ORS 701.065 to carve out a new exception for licensed developers. ORS 701.065 now provides that contractors who are not properly licensed are essentially barred from any administrative or civil remedies. Under these new changes, a licensed developer can "cure" defects in its licensing within certain limitations. Also, there is a special "safe harbor" for licensed developers allowing them to seek remedies for work performed prior to April 1, 2004 if they obtain their CCB license prior to April 1, 2004 (so long as the party met the basic licensed developer requirements during the performance of that work). These licensed developer provisions of SB 906 became operative on October 1, 2003.

C. Real Property

1. Construction Lien "Protection"; HB 3539; 2003 Or Laws Ch 778

This bill is intended to protect residential homebuyers against construction liens that attach to the property after the sale is closed. The bill applies to the sale of any new home or condominium with a sales price over $50,000 and to any existing home that had over $50,000 in improvements during the three months prior to the sale date. The bill does not apply if the structure has four or more units.

If a residence fits within the above definitions, then the owner must provide one of six forms of "protection" for the purchaser: (1) Title insurance against construction liens; (2) An escrow account that is at least 25% of the sale price; (3) A bond or letter of credit in an amount that is at least 25% of the sale price; (4) Written waivers from every potential claimant with at least $5,000 in lien rights; (5) Close the sale after the deadline for recording a lien; or (6) Obtain a written waiver from the purchaser in a form set out in the statute. Prior to the sale, the owner must give the purchaser written notice of the form of protection that is being provided (or that protection is not required). That written notice must be in a form that is designated by the Construction Contractors Board.

A violation of these new requirements is a Class A misdemeanor and can also be an Unlawful Trade Practice. Also, a purchaser can sue the seller for up to twice the amount of actual damages and can recover his reasonable costs and attorney fees. The statute of limitation for such suits is two years after the sale closing date. This new bill also sets forth a number of defenses a seller can raise against claims that the seller violated these new requirements. This bill is effective for sales that occur on or after January 1, 2004.

2. Construction Lien Notices; HB 3539; 2003 Or Laws Ch 778

Aside from the new lien "protection" provisions, this bill reverses a change in the "pre-lien" notice requirements (ORS 87.021) that was created by the 2001 Oregon Legislature. That change created a "circular" definition problem under the statute. Now, HB 3539 repeals that change and the notice requirements are as they were prior to the 2001 Oregon Legislature.

3. Seller Disclosures; SB 515; 2003 Or Laws Ch. 328

This bill modifies the disclosure requirements for sellers of residential real estate. Previously, a seller could choose to either "disclose" or "disclaim" issues concerning the house. Now, all sellers must complete a revised seller's property disclosure statement. Upon receipt of the disclosure statement, a buyer has five business days to revoke the offer. If the seller fails to deliver a completed disclosure statement to the buyer, then the buyer's revocation period extends up to the time of closing. The only times a seller does not have to deliver a completed disclosure statement is: (1) The first sale of a house that has never been occupied (in that instance, the seller must provide a different statement); (2) A sale by a financial institution that obtained title by foreclosure or similar means; (3) Sale by court-appointed parties (receivers, trustees, etc.); or (4) Sale by governmental agencies.

The seller disclosure form itself has been modified from the prior form. A few of these modifications relate to some of the recent construction defect litigation.

D. Design Professionals

1. Discipline of Architects; SB 211; 2003 Or Laws Ch. 165

The authority of the Board of Architect Examiners is now expanded to include two new grounds under which it can discipline an architect: (1) Being convicted of a crime under circumstances that relate to the practice of architecture; and (2) Being the subject of disciplinary action taken by another jurisdiction.

2. Claims against Design Professionals; SB 611; 2003 Or Laws Ch. 418

This bill revises the way in which a party can file legal claims against construction design professionals (architects, engineers, landscape architects and land surveyors). Upon filing any lawsuit or related claim against a design professional, the attorney must include with the claim an affidavit that the attorney has consulted a licensed construction design professional who will testify as to the liability of the construction design professional in the matter at issue.

The affidavit must assert that the expert witness will testify: (1) the defendant's conduct failed to meet the applicable standard of professional care, and (2) the alleged conduct was the cause of the claimed damages. In lieu of this affidavit, the attorney can submit an affidavit swearing the applicable statute of limitations is about to expire and the attorney will submit a qualifying affidavit within 30 days after filing the claim. The bill limits the types of claimants that it applies to (in other words, there are some claimants who do not have to meet these new criteria). This bill applies only to claims filed on or after January 1, 2004.

E. Public Works Projects

1. Subcontract Disclosures; HB 3422; 2003 Or Laws Ch. 535

The law has once again been revised in regard to the disclosures that must be made by bidders on public improvement contracts. First, the disclosures must now be made within two hours after bid opening (previously, it was four hours after bid opening). Second, disclosures must be made only if the public improvement contract value exceeds $100,000 (previously, it was $75,000). Third, the disclosure must now include the dollar amount of each disclosed subcontractor (as well as the prior requirement to disclose the name and category of work). Fourth, there is now a statutory disclosure form. If there are no subcontractors that meet the disclosure criteria, then the form must be turned in with the word "none" written on it. The failure to submit the form means the bid is deemed nonresponsive. Finally, this is an "emergency" bill that applies to all public improvements that are first advertised after August 1, 2003.

2. Public Contracts; HB 2341; 2003 Or Laws Ch 794

See prior article for a summary of this bill.

3. Energy Conservation; HB 3476; 2003 Or Laws Ch. 562

This bill allows "energy savings performance contracts" to be exempt from the public procurement requirements of ORS Chapter 279. These contracts are defined as one between a public agency and a qualified energy service company for all aspects of energy conservation measures. It can include design build contracts. The Oregon Attorney General must adopt model rules that can be used by public bodies concerning the relevant procedures.

UPCOMING CLES

November 18, 2003: "Insurance and Surety Issues"

This CLE will present an overview of insurance and surety issues as well as a brief discussion of some current "hot topics" in these areas. The presenters will include Richard Kowalski and Charles Hersh of Anchor Insurance.

The CLE will be held at the Downtown Greek Deli in Portland from noon until 1:30.

The section's annual meeting will be held after the CLE. Elections will also be held for the following positions:

EXECUTIVE SECTION NOMINATIONS

The nominees for the next Construction Law Section election (to be held in December) are as follows:

David Douthwaite, past chair:
ddouthwaite@jedunn.com
Roger Lenneberg, chair:
roger.lenneberg@pcg.com
Janelle Chorzempa, chair-elect:
chorzempa@mca-law.com
Jack Levy, secretary: jlevy@smithfreed.com
Dana Anderson, secretary:
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Members at Large:
Nancy Cary, renewal: ncary@hershnerhunter.com
Darien Loiselle, new member:
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James Van Dyke, new member:
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Construction Law Section Executive Committee

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Janelle Chorzempa, secretary:
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Jack Levy, treasurer: jlevy@smithfreed.com
Rod Mills, past chair: rmills@seifer-yeats.com

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