Construction Law Newsletter

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MESSAGE FROM THE CHAIR

Jason Alexander
Sussman Shank

As the newest Chair of the Construction Law Section of the Oregon State Bar, welcome to the first Construction Law Newsletter for 2014. As Chair, my primary goal for this year is to carry on the wonderful work and leadership of our past committee members and Chairs, including our most recent past Chair, Peter Vitiznek. To that end, we will continue to focus the Section's time and resources toward endeavors that educate and help the members of the Construction Law Section.

We are here to serve you, our members. Please do not hesitate to contact me (or anyone else on the Board) if you have any ideas, suggestions, or wish to become more involved in the Construction Law Section. The more we hear from you, the more relevant we can make the Section to its members.

Some of our action items for 2014 are as follows:

1. Annual CLE: The Board members are currently in the planning stages for a Construction Law CLE to be set in October 2014. While exact speaking topics have yet to be finalized, our focus will be to present timely and relevant construction issues for today's Oregon practitioner.

2. Brown Bag Lunch Series: We will continue to sponsor the "Brown Bag" lunch series, which is designed to touch on the "nuts and bolts" of construction issues.

3. Newsletter: We will continue to publish our section newsletter three times a year. We will strive to publish informative and interesting articles that will help keep our members abreast of the ever-changing construction environment. We are fortunate that Alan Mitchell has agreed to continue to act as editor of the newsletter. Without his tireless work behind the scenes, the newsletter as you know it would not be possible.

4. Section Website: Starting last year, and continuing this year, we are under way with efforts to update the website and make it more useful to our members. Among other things, the website will list upcoming events, contact information for board members, useful construction-related links, copies of past newsletters, and the status of pending legislation important to the construction industry.

I am excited for this year. We have a strong and energetic board with a wide array of construction-related experience. The more our membership participates, the stronger the construction law section will become. We hope to hear from you as 2014 progresses.

CONTRACTORS HAVE ACCESS TO EQUITY BASED RELIEF EVEN WITHOUT LIEN RIGHTS

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This article addresses the availability of equity-based relief in certain construction scenarios. Specifically, it answers the question of whether a construction lien is an exclusive remedy against an owner for parties without a direct contractual relationship with the owner of a construction project.

Tum-A-Lum Lumber[1] is often incorrectly cited for this premise, and citations to *Safeport*[2] would suggest that a lien must be pursued and must provide an inadequate remedy before an equitable remedy can be asserted against an owner. In fact, *Tum-A-Lum Lumber* merely requires a subcontractor to exhaust its remedies against a direct contracting party prior to looking for equitable relief from other parties. Further, exhausting remedies can mean unsuccessful pursuit of a lien, including the claimant's failure to follow the statutory lien scheme.

In *Tum-A-Lum Lumber*, a material supplier filed a lawsuit against the owner of a construction project alleging unjust enrichment for materials that had not been paid for by the general contractor. The Court cited Idaho and Tennessee decisions for the rule that the furnisher of materials must have exhausted all remedies against the contractor and still remain unpaid. The Court found that the supplier had not exhausted its remedies because it had only made a demand on the contractor but did not sue the contractor or file a lien against the property.[3] In *dicta*, the Court stated that the notice provisions in Oregon's statutory lien scheme supported this holding, as did the Restatement (Second) of Restitution supported its holding.[4]

The Court's implication that a supplier must file and foreclose a lien in order to recover in equity takes the cited Idaho and Tennessee decisions too far. The Idaho court, in *Idaho Lumber, Inc.*[5], considered the case of a contractor hired by a lessee to remodel a building. The contractor filed a lawsuit seeking to foreclose a construction lien as to the lessee and the owner/lessor and seeking damages on a theory of quasi-contract for unjust enrichment.[6] The lessee filed bankruptcy; thus, it follows that the supplier had exhausted its remedy against the party with whom it had a direct contract. The court turned to the supplier's claims against the owner. The lien was not timely and was barred on a technicality. But this did not prevent the supplier from recovering against the owner for unjust enrichment, which it did.

The Tennessee court, in *Paschall's, Inc.*[7], considered the case of a contractor that supplied labor and material to the occupant of a house who happened to be the daughter of the owner of the house. The contractor attempted to collect its debt against the daughter/occupant, but she filed for bankruptcy and the debt was discharged.[8] The contractor sued to secure a mechanic's lien on the owner's property and to recover a personal judgment against the owner for the value of the labor and materials furnished. The contractor failed to comply with Tennessee's statutory lien scheme and the trial court sustained a demurrer against the complaint. In reversing and remanding, the Tennessee court found that the contractor's lien was not the sole and exclusive remedy against the owners and instead held that

[1] *Tum-A-Lum Lumber v Patrick*, 95 Or App 719, 770 P2d 964 (1989).
[2] *Safeport, Inc v Equipment Roundup & Mfg, Inc*, 184 Or App 690, 60 P3d 1076 (2002)
[3] *Tum-A-Lum Lumber,* 95 Or App 721-2, fn 4.
[4] *Id.*, at 721-22, fns 2 and 3.
[5] *Idaho Lumber, Inc v Buck*, 109 Idaho 737, 710 P2d 647 (1985).
[6] *Id.* at 739.
[7] *Paschall's Inc v Dozier*, 219 Tenn 45, 407 SW2d 150 (1966).
[8] *Id.* at 152.

the contractor could proceed with its unjust enrichment claim against the owners.

In *Guarantee Electric Company*[9], Kentucky's federal court completed a survey of various state laws to determine whether a construction lien is an exclusive remedy under Kentucky law and whether a subcontractor would not be able to pursue a quantum meruit claim against the owner because it had failed to exercise its lien rights. The Kentucky court held that a lien was not an exclusive remedy and that a contractor could sue an owner in equity. In its analysis, the court observed that the primary function of a lien is to create a claim by law to secure priority of payment, *in rem*, that affects only the property.[10] The common law action, on the other hand, creates no priority and results in a money judgment against the person, *in personam*. These are distinct claims and support the need to exhaust any remedy against a direct contracting party, including any security, before pursuing other parties in equity.

In sum, unpaid subcontractors can pursue equitable theories against owners once they have exhausted claims against parties with whom they have a direct contract, including exhausting unsuccessful lien claims. However, this is not full relief for an unpaid subcontractor because equitable remedies can be subject to various strong defenses.

INSURERS MUST DEFEND EVEN WHEN THEY DON'T HAVE TO

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The good news for contractors is that in construction defect actions in Oregon, a commercial general liability insurer must provide a defense even if the subject policy includes a continuing damage exclusion that seemingly should exclude coverage. In the recent case of *Navigators Ins. Co. v. K&O Contracting LLC*, 2013 U.S. Dist. LEXIS 171392 (D. Or. Dec. 4, 2013), the United States District Court for the District of Oregon held that even in the face of undisputed extrinsic evidence that the insured's construction work was completed prior to the policy inception date, the evidence could not be considered to terminate the insurer's duty to defend.

The duty to defend typically is triggered based on the policy terms and the allegations of the complaint. Under the oft-mentioned "8 corners rule," if the claim stated in the underlying complaint, without amendment, could impose liability for conduct covered by the insurance policy, the insurer has a duty to defend the claim. The duty arises if the complaint provides any basis for which the insurer provides coverage.

Many modern commercial general liability insurance policies include exclusions with respect to property damage that occurred or arose out of defective construction work that existed prior to the inception of the policy. One such exclusion is the "Continuous or Progressive Injury or Damage Exclusion," which typically provides as follows:

> This insurance does not apply to any damages because of or related to bodily injury or property damage:
>
> 1. Which first existed, or is alleged to have first existed, prior to the inception date of this policy;
>
> 2. Which are, or are alleged to be, in the process of taking place prior to the inception date of this policy, even if the actual or alleged bodily injury or property damage continues during this policy period, or
>
> 3. Which were caused, or are alleged to have been caused, by the same condition or construction defect which resulted in bodily injury or property damage which first existed prior to the inception date of this policy.

[9] Guarantee Electric Company v Big Rivers Electric Corp, 669 FSupp 1371 (1987).
[10] *Id.* at 1379.

> We shall have no duty to defend any insured against any loss, claim, or suit or other proceeding alleging damages arising out of or related to bodily injury or property damage to which this endorsement applies.

It is frequently the case that a review of the construction contracts, invoices and completion notices shows that the work complained of was completed several years before the policy inception date. Commonly in such situations, counsel for a project owner bringing suit against the developers and contractors for damages from construction defects will omit from the complaint any dates of construction or completion. In this way, continuous damage exclusions are not implicated, and the insured may be entitled to a defense to which it might not otherwise be entitled were the dates of construction mentioned in the pleading.

In *Navigators Ins. Co. v. K&O Contracting LLC*, Navigators brought an action seeking a judgment declaring it had no duty to defend its policyholder in a construction defect action, based on the continuous damage exclusion. The complaint did not include any dates of construction, but Navigators offered admissions from the insured establishing that the construction work had been completed well before the policy incepted.

The court noted that under Oregon law, extrinsic evidence could not be considered at all, absent certain very limited circumstances that were not present in the case. The magistrate discussed cases from other courts in which the duty to defend can be terminated based on undisputed evidence of no coverage, going so far as to state that "the prevailing view may seem the most reasonable and logical." But, in the absence of specific authority in Oregon, the magistrate held, and the district judge agreed, that the relief sought by Navigators could not be granted.

The prohibition on considering extrinsic evidence to allow an insurer to avoid the defense allows owners' lawyers to omit any facts that are not relevant to their clients' claims but which may significantly impact an insurers' defense and indemnification duties. The consequence is that insurers end up defending claims for which there will never be a duty to indemnify. This is a significant benefit to contractors, for as long as current law lasts.

MERS UPDATE IN OREGON

Bill Fig
Sussman Shank

The downturn in the housing market during the "great recession" obviously affected the construction industry. With home loan defaults and foreclosures reaching numbers not seen since the Great Depression, the lending industry was also seriously affected. Not surprisingly, the tidal wave of home loan defaults and related foreclosures resulted in an increased focus on and scrutiny of the lending industry, the securitization of home loans, and the nonjudicial foreclosure processes in Oregon and Washington. Regarding nonjudicial foreclosures, the designation of Mortgage Electronic Registration Systems, Inc. ("MERS") as a beneficiary of a Deed of Trust became a "hot button" issue that generated significant litigation.

In many Deeds of Trust recorded in the last 15 years, especially residential ones, MERS is identified as the beneficiary of record, as nominee for the lender and for the lender's successors or assigns. As a result, MERS remained the record beneficiary of a Deed of Trust when the promissory note secured by the Deed of Trust was sold between lenders who were MERS members. In such a situation, no Assignment of the Deed of Trust was recorded.

In 2011, ORS 87.005(6) was amended to address confusion regarding who must receive lien notices when MERS is named as the beneficiary in a Deed of Trust. That statute defines "mortgagee" as a person whose name and address appear as mortgagee or beneficiary in a trust deed of record or in an assignment of a trust deed of record that is

recorded with the county clerk of the county within which the property or improvement is located.

In 2013, the Oregon Supreme Court generally held that MERS cannot independently act as the beneficiary of a Deed of Trust unless it held the secured note (or owned the loan), which it typically does not. Thus, when a note is sold or transferred, the associated Deed of Trust, by operation of law, follows the note making the new note holder the beneficiary of the Deed of Trust. The court did recognize that MERS may act as an agent of a disclosed beneficiary.

While the Oregon Supreme Court's recent MERS ruling has raised some interesting questions regarding the foreclosure of a MERS Deed of Trust, the court's ruling does not appear to affect Oregon construction lien law. ORS 87.005(6) does not require the lien claimant to investigate the identity of the mortgagee beyond identifying the person whose name and address appear as the beneficiary or mortgagee in a recorded trust deed or assignment thereof.

Both the original lender and MERS should be identified in the Deed of Trust. In an abundance of caution, any required notice should be sent to both parties. It is very likely, however, that the original lender sold the note to another qualifying lender (*i.e.* MERS member) shortly after the Deed of Trust was recorded. MERS' website, *www.mers-servicerid.org*, allows a person to determine the identity of the current investor (*i.e.* the owner) of a loan, if the loan is still in the MERS system. While not necessary under ORS 87.005, it may be beneficial to send the current lender a courtesy copy of a notice.

Typically, if the loan is no longer in the MERS system, MERS will have recorded an Assignment of the Deed of Trust to the current owner of the loan. This makes the inquiry under ORS 87.005 easier because, after such an Assignment is recorded, MERS' involvement with the Deed of Trust should be of no consequence. The party who must receive notice is simply the identified assignee of the Deed of Trust.

HOME BUYERS AND CONTRACTORS BEWARE: LESSONS FROM *HETTLE V CCB*

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A recent Oregon Court of Appeals case not only highlights some of the challenges a potential home buyer faces during the negotiation process when potential defects are discovered, but also provides guidance regarding the nature of claims the home buyer can pursue against a contractor hired by the seller.

The case, *Hettle v. Construction Contractors Board*, 472 Or. App. 135 (Dec. 18, 2013), involves a home buyer's complaint through the Oregon Construction Contractors Board ("CCB") against a contractor hired by the home seller. While the contractor in *Hettle* ultimately prevailed, the case also demonstrates some of the perils a contractor faces when providing an opinion regarding the condition of a home. [11]

A complainant may file a CCB complaint against a contractor for breach of contract, improper work or negligent work under ORS 701.140. While the CCB no longer adjudicates claims filed on or after July 15, 2011, the CCB continues to process complaints within their jurisdiction against contractor license bond sureties.

The license bond, which typically ranges from $15,000 to $20,000, may be an important source of payment for judgments or arbitration

[11] A contractor peril not discussed in *Hettle* is that a contractor who provides "home inspection services" generally must be specially licensed to do so, and if so, may not thereafter perform work on the same structure for a period of 12 months. See ORS 701.350-.360.

awards based upon a construction defect claim within the CCB's jurisdiction.[12]

In *Hettle*, the buyer and seller negotiated for the purchase of an existing residential home. During the due diligence process, a home inspector suspected an exterior water intrusion problem around certain windows due to swelling of the wood sills. The inspector, presumably hired by the home buyer, recommended someone retain a "qualified specialty contractor" to evaluate and remediate the water intrusion and damaged areas as appropriate.

As a condition of purchase, buyer and seller entered into a "Buyer's Repair Addendum" whereby seller agreed to remove moss from the roof and retain a licensed contractor to identify and remediate the source of the water intrusion associated with the window sills and repair the damaged areas. The seller hired a contractor to remove the moss. The seller also requested the same contractor review the windows identified by the home inspector and write a letter of his findings.

The contractor, contrary to the home inspector, wrote that other than some superficial damage to the interior of the window sills, there was "absolutely no mold, dry rot or other damage." *Id.* at 138. Unbeknown to the contractor, the seller provided the report to the buyer to rely upon as satisfying the Buyer's Repair Addendum. Several months after closing, the buyer discovered significant water intrusion damage – including mold and dry rot - contrary to the purported "report" provided by the seller's contractor.

Because the parties in *Hettle* conditioned the home purchase upon repairs performed by the contractor, the home buyer (upon satisfying various timeliness and other requirements) was entitled to pursue a CCB complaint for negligent or improper work against the seller's contractor, including the contractor's license bond. Such remedies through the CCB remain available today (albeit under a different procedure than described in the *Hettle* case). See OAR 812-004-0320.

Under the procedure that existed for complaints filed prior to July 15, 2011, the *Hettle* home buyer's complaint against the contractor went before an Administrative Law Judge ("ALJ"). Unfortunately for the home buyer, the ALJ dismissed the complaint. The ALJ found that the seller failed to disclose to the contractor the home inspector's findings regarding the suspected water intrusion or the existence of the Buyer's Repair Addendum.

The seller also failed to disclose that the source of water intrusion was a significant concern. Instead, the ALJ found the seller led the contractor's president to believe that the seller's concerns involved whether the contractor had caused any damage when it pressure washed the home as part of the moss removal process. As a result, the contractor only reviewed the inside of the window sills, not the exterior where the damage occurred. The court found the ALJ's facts were substantially supported by the record.

Moving to the ALJ's legal conclusions, the court analyzed the language and context of the ORS 701.140, which provides that a complainant may only file a complaint against a contractor for "improper work" or "negligent work."

The court upheld the ALJ's dismissal of the home buyer's complaint based on "improper work." The *Hettle* court held the phrase "improper work" means the "work was not suited to the circumstances under which the work was performed." *Id.* at 145. As a result of the seller's conduct and non-disclosures, the court in *Hettle* held the ALJ did not err by dismissing the "improper work" complaint against the contractor.

The court also upheld the ALJ's dismissal of the buyer's complaint based on negligence. The

[12]Also, the CCB will have authority to adopt its own dispute resolution process for complaints arising out of residential projects that are filed on or after July 15, 2017, raising the possibility the CCB will again provide an arbitration or contested case hearing process that existed for complaints filed prior to July 15, 2011. See Section 73, Chapter 630 Or Law 2011.

Hettle court held the phrase "negligent work" in ORS 701.140 refers to common law negligence principles "and does not create an independent cause of action." *Id.* at 148. While the facts of the case never clearly describe the damage incurred by the home buyer, it is clear the ALJ assumed the home buyer's damages were economic damages (not property damage), and therefore concluded that homebuyer's damages were only recoverable if the contractor was subject to a heightened standard of care, such as one arising out of a special relationship or statute. *Id.* at 147 (citing *Abraham v. T. Henry Construction, Inc.*, 350 Or 29, 40 (2011)). Finding no special relationship, the ALJ dismissed the homebuyer's complaint under what is generally known as the economic loss doctrine of Oregon negligence law.

The appeals court affirmed the ALJ's dismissal of the case based on the economic loss doctrine. In doing so, the court observed the following limitation of its review on appeal in an important footnote:

> *Neither party* contends that the loss experienced in this case was *not* economic and, for that reason, no "special relationship" requirement existed. Because the parties do not raise this issue, we do not address it. *See Harris v. Suniga*, 344 Or 301, 310, 180 P3d 12 (2008) (defining "economic").

Id. at 143 n.5 (*Emphasis added*). To uphold the ALJ's dismissal, the court distinguished the facts of the *Hettle* case from *Meininger v. Henris Roofing & Supply*, 137 Or App 451 (1995).

In *Meininger*, the court held that a heightened standard of care sufficient to support a claim in negligence for economic losses existed between a roofing company hired by a home seller and a remote purchaser. Specifically, the seller in *Meininger* hired the roofing company to evaluate the condition of a roof for the purpose of representing the condition of the roof to a potential home purchaser. *Hettle*, 260 Or App at 149-150. By contrast, the seller in *Hettle* never informed the contractor of the purpose of the inspection or that the visual inspection was inadequate for the seller's purposes. *Id.* at 150. As a result of these facts and other circumstances, the court held the contractor did not had sufficient information to know about--and thus be required to pursue—the home buyer's economic interests as is necessary to establish a "special relationship" necessary for the recovery of economic losses under Oregon negligence law. *Id.* at 151. The court also held that ORS 701.140 and OAR 812-004-0320 did not create a special relationship (as those provisions only described the CCB's jurisdiction to hear negligence claims). *Id.* at 152-153.

In sum, the *Hettle* case illustrates the manner in which a home buyer may use a "repair addendum" in the context of a home purchase to potentially obtain additional protections, as well as the significant risk a contractor incurs when hired to review a home for the purpose of a sale transaction. In short, when it comes to repair addendums to home purchase agreements, "buyer" *and* "contractor" beware.

COURT OF APPEALS AGAIN ADDRESSES ORS 30.140(2)

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On December 4, 2013, the Court of Appeals issued its decision in *Montara Owners Association v. La Noue Development , LLC*, 455 Or App 657 (2013), reaffirming its decision in *Hays v. Centennial* Floors, Inc., 133 Or. App. 689 (1995), and further limiting its decision in *Walsh Construction v. Mutual of Enumclaw*, 189 Or. App. 400 (2003) to the particular facts of that case. It also provided further support for using diminished value as a measure of damages in construction defect cases, when repairs would amount to economic waste.

The Court summarized the facts: "The dispute here is a familiar one; a construction defect action by a homeowners association against the developer and general contractor, who then filed third-party complaints against multiple subcontractors." *Id.* at 660. The project that was the subject of this particular action was the Montara townhouses located in Portland, Oregon, and consisting of approximately 35 townhomes developed and constructed between 1999 and 2004.

In 2005, the Montara Owners Association (the "Association") brought an action against the developer/general contractor, La Noue Development, LLC ("La Noue"), alleging physical damage to the townhomes resulting in water intrusion. The homeowners sought almost $7.5 million in repairs, alleging that all siding, windows and roofs would need to be removed as part of the repairs.

La Noue brought a third-party complaint against over twenty of its subcontractors, alleging negligence, breach of contract, common law indemnity, contractual indemnity, and contribution claims. The subcontractors including Sharabarin, dba Advanced Construction, ("Sharabarin"), the sider of four of the buildings in the nine building project. La Noue settled with the homeowners, as well as most of the subcontractors, but proceeded to trial as to several of the subcontractors, including Sharabarin.

Due to pretrial motion practice, the only claim proceeding to trial was La Noue's breach of contract claim. Although La Noue was alleging damages of over $2 million, this amount was limited by the court to settlement payments already made by the other subcontractors as well as La Noue's insurer to the homeowners. The jury found in favor of La Noue, and awarded La Noue $43,711 in damages against Sharabarin. La Noue appealed the trial court decision.

This article focuses on the decision reached on two of La Noue's assignments of error.

Assignment of Error #1: Jury Instruction of Measure of Damages as to La Noue's Contract Claim.

The trial court submitted an instruction to the jury as proposed by Sharabarin; it was a modified instruction to UCJI 65.18. The instruction set forth that the cost of repair or replacement was the correct measure of damages if the jury found Sharabarin breached its contract with La Noue; however, if repair costs amounted to economic waste, then the proper measure of damages would be diminished value. This instruction was based on the Supreme Court's decisions in *Beik v. American Plaza Co*., 280 Or. 547, 555-56 (1977) and *Newlee v. Heyting*, 167 Or. 288 (1941).

The Court of Appeals reversed the trial court's decision, and remanded the issue of measure of damages back to the trial Court. The Court of Appeals reasoned that:

> "Assuming that Sharabarin might have been able to present to the jury an alternative to normal expectation damages based on the economic waste doctrine, he bore the burden of proving the amount of damages the jury should award if it applied that doctrine, namely the diminished value of the townhouses . . .Sharabarin did not meet his burden due to a lack of evidence, and there was, consequently, no basis in the evidence to give the instruction concerning economic waste or diminished value.

Id. at 665. In making the decision, the Court of Appeals specifically rejected an argument by La Noue that different contract principles govern the relationship between a general contractor and its subcontractors, and therefore the economic waste rule should not apply, finding, "[w]e are not persuaded by La Noue's argument that the contractor and subcontractor relationship is so unique that we should create a per se rule concerning how damages are determined." *Id.* at 668. The Court's reasoning was simple; once Sharabarin had proposed an alternate measure of damages, it was then Sharabarin's burden of proof to establish what those damages were.

Assignment of Error #3: ORS 30.140(2) Can Save an Indemnity Provision that Violates ORS 30.140(1).

Sharabarin's written subcontract with La Noue included an indemnity clause. The language of the indemnity clause required Sharabarin, "to indemnify La Noue for any loss arising out of Sharabarin's work, even if the loss was caused in part by La Noue itself, except if the loss was caused by La Noue's 'sole' negligence. *Id.* at 677. The trial court granted Sharabarin's motion for summary judgment , and found that the indemnity clause was void pursuant to ORS 30.140(1), in that it required Sharabarin to indemnify La Noue for losses caused in part by La Noue.

ORS 30.140 provides as follows:

(1) Except to the extent provided under subsection (2) of this section, any provision in a construction agreement that requires a person ***to indemnify another against liability for damage arising out of ***damage to property caused in whole or in part by the negligence of the indemnitee is void.

(2) This section does not affect any provision in a construction agreement that requires a person *** to indemnify another against liability for damage arising out of *** damage to property to the extent that the *** damage to property arises out of the fault of the indemnitor.

Id. at 677, citing ORS 30.140.

The Court of Appeals reversed the trial court's decision, finding that, "[t]he core issue of statutory construction here is whether, as La Noue contends, ORS 30.140(2) states an exception to subsection (1) or, as contended by Sharabarin, the statute describes two different types of indemnity agreements, those that are void, and those that are enforceable." Id. at 678. The Court found that La Noue's interpretation of the statute was the more accurate one, in that Sharabarin's proposal would render part of the language of ORS 30.140 superfluous. The Court went on to reason, "[a]n indemnity clause that offends ORS 30.140(1) because it requires a subcontractor to indemnify a contractor for the contractor's own negligence remains enforceable to the extent that it also requires the subcontractor to indemnify the contractor for the subcontractor's negligence." *Id*. at 582. The Court of Appeals interpreted the statute so that ORS 30.140(2) acts as a saving clause to a provision that would otherwise be void under ORS 30.140(1).

This was not new ground for the Court of Appeals. The Court had come to the same decision for a previous version of ORS 30.140 in the case of *Hays v. Centennial Floors, Inc*., 133 Or. App. 689, 695 (1995). The statute was amended subsequent to *Hays*. However, subsequent to *Hays*, the Court of Appeals issued its decision in *Walsh Construction Co. v. Mutual of Enumclaw*, 189 Or App 400 (2003) *aff'd* 338 Or 1 (2005), where it did find a contractual indemnity provision void under ORS 30.140(1). The Court of Appeals in *Montara* was quick to limit its decision in *Walsh*, reiterating what the Supreme Court had stated in its own opinion when it affirmed that case, that there had been no contention in *Walsh*, that the subcontractor had been negligent.

Conclusion

The decision by the Court of Appeals seems to accept the plausibility of La Noue's argument that ORS 30.140(2) operates to save those provisions of the indemnity statute that do not violate ORS 30.140(1), as well as Sharabarin's argument that there are two types of indemnity clauses, those that are void under ORS 30.140(1), and those that are allowed under ORS 30.140(2). The Court of Appeals concedes that, "[t]he question is a close one." *Id.* at 682. The Court of Appeals reached its decision by coming to the conclusion that, "[u]ltimately, we conclude that La Noue's interpretation of the statute is more persuasive." *Id.*

This is not a ringing endorsement for the saving power of ORS 30.140(2) and it is a difficult position for the Court of Appeals to be in. ORS 30.140 is a statute that even after two revisions (originally written in 1973, it was revised in both

1987 and 1995) can be plausibly interpreted different ways depending on whether you are representing a general contractor or a subcontractor. The Court of Appeals in *Montara* looked closely at the Supreme Court's affirmance of *Walsh, supra,* and the Supreme Court's examination of the 1995 amendments to ORS 30.140:

> Thus, the 1995 amendments essentially inverted the structure of the 1987 version of the statute. Whereas subsection (1) of the 1987 revision of the statute defined a universe of permissible indemnification provisions, subject to the 'notwithstanding' exception set out in subjection (2), subsection (1) of the 1995 statute stated a general prohibition of indemnification provisions, subject only to the exception described in subjection (2). In addition, the general proscription, now embodied in subsection (1), was expanded to encompass agreements to indemnify for damages arising 'in part' from the indemnitee's own negligence.

Montara, supra at 681. Although the analysis is interesting, it is not very helpful. At first glance it would appear that the amendments were an attempt to make ORS 30.140 stronger – a prohibition to indemnity clauses in construction contracts with an exception, as opposed to the other way around. But it certainly does not provide much clarity as to whether the statute should be used as a way of rehabilitating indemnity clauses that are void under subsection (1), or voiding those provisions altogether.

However, other than the opportunity to possibly get out of a contractual indemnity claim at summary judgment, it will be interesting to see what will really change in light of the *Montara* decision. The question will continue to be how much can a general contractor recover under a contractual indemnity clause once a subcontractor hires counsel, defends against damages attributable to his or her work, and a jury apportions liability as to all the parties that end up in court. The worst possible scenario for a subcontractor will continue to be cases where the facts are similar to *Montara*, and the general contractor/developer has settled with a homeowners' association. However, even in *Montara*, the jury came remarkably close to awarding what Sharabarin's expert testified was Sharabarin's percentage of liability for a reasonable repair number, even after receiving jury instructions as to diminished value. See *Montara*, fn 4. Although motion practice is ideal, at the end of the day ORS 30.140, and a good jury, will still limit damages under a contractual indemnity claim.

HOMEOWNERS VS CONTRACTORS: A NIGHTMARE FOR ALL?

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Many of us have represented either a homeowner or a contractor in a dispute between those two parties. Based on my personal experience, I have to wonder how often those situations end up in a good resolution.

My general observation is that, by the time a homeowner is ready to contact an attorney, the homeowner is often so upset that he is virtually beyond reason. Often, the contractor is not able to understand why the homeowner is so upset. From there, the communication frequently goes downhill.

From the initial stages of this relationship, there are potential hazards. First, most homeowners are generally not experts in construction. All a homeowner knows is that he wants to have work done on his home (aka his private refuge from the toils of the universe). He asks around and eventually finds a contractor to hire. The homeowner probably does not really read all of the paperwork (isn't that nothing more than a bunch of legal jargon?). Also, homeowners may see the contactor's services as a commodity that can be

fully quantified rather than something that may need to be a bit fluid as circumstances change.

The one crucial element is that the homeowner places a huge amount of trust upon the contractor. The homeowner trusts that the contractor will do good work (however that is defined) and also trusts that the contractor will charge a reasonable fee (again, however that is defined). I cannot overestimate the importance of this feeling of trust. Once a homeowner feels that this trust has been breached, then he can quickly move into the "hell hath no fury" zone.

From the contractor's perspective, he is generally better with his hands than with his communication and business skills. He goes through life making things happen and then looking back at them with satisfaction. Hopefully, others appreciate the time and effort involved in achieving those results. For the most part, he wants only to be paid a reasonable amount for his well-performed services. He may feel that a construction contract is just one of those necessary evils and that his mantra of "my word is my bond" should be sufficient guaranty of his performance.

Then, once the project gets underway, unexpected issues arise. This may be in part because one or both of the parties did not fully appreciate the potential for unknown issues to arise – whether those be unforeseen conditions, building code issues, different interpretations of the construction plans, weather, or whatever. The contractor is used to this and takes it all in stride. He realizes that changes regularly arise and he is prepared to make the necessary revisions. Of course, he will expect to receive extra compensation, especially since the change was not something within the terms of the parties' original agreement.

Unfortunately, the contractor may not fully explain all of this to the homeowner (again, contractors tend to be better with hands than communication). The homeowner, seeing that the contractor is not too excited about this, may assume that the contractor had anticipated these kinds of situations when the contractor put together his price.

In addition, it is not unusual for homeowners to stretch (overstretch?) the boundaries of their budget versus their desired scope of work. Then, once the homeowner has their mind wrapped around a budget, they may not closely analyze how the scope of work is impacting the budget. Most of us have experienced the phenomenon of our eyes being larger than our wallets. Contractors need to be more careful to remind homeowners to rein in that natural tendency and to not focus on the exciting finishes over the underlying structural elements.

Then the contractor sends his revised or final bill to the homeowner. Not surprisingly, the bill is not very well articulated (at least from the homeowner's perspective). The homeowner may be unpleasantly surprised and may lash out at the contractor. In response, the contractor may become defensive. From there, things likely get worse.

It is not unusual for the two sides to fail to understand the other side's issues and concerns. The contractor may fail to appreciate that a homeowner may see things through his professional viewpoint – for example, if the homeowner is an engineer, the contractor could expect the homeowner to be very detail-oriented. Or, if the homeowner is an architect, the contractor should expect the homeowner to be more concerned with the final product than with what it takes to get to the point.

On the homeowner's side, they sometimes feel that the contractor is too focused on running the contractor's business rather than working to ensure that the homeowner's castle is fully protected. For most homeowners, these projects may involve some of their largest expenditures and they are understandably concerned about getting value for their hard-earned money. On the flip side, the contractor may feel that he is being asked to be a personal bank to the homeowner (at zero interest).

Attorneys who become involved in these kinds of disputes need to be very careful. The attorney for each side needs to warn his client that these disputes can take many months (if not years) to reach a final resolution. The attorney should clearly document that he has addressed the issue of

whether the clients – whether they be homeowners or contractors – really want to spend that much of their time and energy involved in a legal fight.

Also, each attorney should counsel his client that these disputes can involve considerable legal fees and costs. The attorney in these kinds of disputes should not be surprised if, after a settlement is reached, the client does not want to pay all of the attorney's fees because "after all, you didn't really get me what I wanted." Also, attorneys should be careful about inflating their client's expectations. Thus, adding Unlawful Trade Practice Action claims or obtaining excessive repair estimates may make it more difficult for the parties to reach a final resolution.

Mediators sometimes find that the parties have not really undertaken a full cost-benefit analysis. Parties need to consider not only the costs involved in moving forward with a dispute but also whether any of those costs may be recoverable. Homeowners need to remember that residential contractors have only a $20,000 surety bond as part of their CCB licensing and that the CCB's current rules do not allow for payments out of that surety bond to include attorney fees (see OAR 812-004-1250). Since the current CCB statutes do not allow the agency to issue an order requiring a surety to pay out of that bond until the complainant obtains a court judgment, the amount of those attorney fees should not be ignored.

Another issue that mediators sometimes have to address is the parties' failure to either read or fully understand the contract. For example, while some contracts say they are a time and materials contract, they still include a total budget amount or specific line item budget amounts. Contractors need to be aware that homeowners will likely treat those "budget" amounts as fixed-price line items. Homeowners will have to be reminded just what is truly meant by "time and materials."

The bottom line is that, just as homeowners and contractors should be more cautious when entering their relationship, so should attorneys be more cautious about representing one of the parties in these kinds of disputes. It is not unusual for an attorney to have a client who is both legally unsophisticated and highly emotional – two factors that can contribute to a sour attorney-client relationship. As at least one mediator has said to me: Never let pride get in the way of settlement.

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