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EXPLAINING CHANGE ORDERS WITH EXTRINSIC EVIDENCE

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The interpretation of a change order is subject to the same rules used for the interpretation of contracts. There is, however, disagreement between state and federal courts as to what the rules permit in regard to extrinsic evidence. An analysis of Oregon court decisions involving change orders shows that at least one past case does not comport with current rules. Finally, because courts determine whether a contract is ambiguous and whether prior oral agreements are admissible as questions of law, change orders should be extraordinarily explicit, even to the point of memorializing matters the change order does not address.

A. May Extrinsic Evidence Be Considered To Determine If A Contract Is Ambiguous?

1. Case Law Supporting View That Extrinsic Evidence May Only Be Introduced After The Court Determines The Contract Is Ambiguous

The process by which contracts are construed was recently summarized in *McKay's Market of Coos Bay, Inc. v. Pickett,* 212 Or App 7, 157 P.3d 291 (2007):

> The applicable legal principles are familiar. When we interpret any written instrument, our objective is to ascertain the meaning that most likely was intended by the parties that entered into it. ORS 42.240 ("In the construction of an instrument the intention of the parties is to be pursued if possible"). That objective applies to the interpretation of contracts, including deed restrictions. *Yogman v. Parrott*, 325 Or 358, 364, 937 P.2d 1019 (1997) (citing ORS 42.240). We ascertain the meaning most likely intended by the parties by means of a three-step inquiry. *Id.* at 361-63, 937 P2d 1019. We begin with the text of the disputed provision in the context of the instrument as a whole. *Id.* In examining the text of the disputed provision we determine whether that provision is ambiguous, for, if the provision is unambiguous, we enforce the provision according to its terms as a matter of law. *Eagle Industries, Inc. v. Thompson*, 321 Or 398, 405, 900 P.2d 475 (1995). A contractual provision is "ambiguous" only if it is capable of more than one plausible and reasonable interpretation. *Batzer Construction, Inc. v. Boyer*, 204 Or App 309, 313, 129 P.3d 773, *rev. den.,* 341 Or. 366, 143 P.3d 239 (2006). If the disputed provision is ambiguous, we proceed to a second step that involves examining extrinsic evidence of the contracting parties' intent. *Yogman*, 325 Or at 363, 937 P2d 1019. If resort to such extrinsic evidence does not resolve the ambiguity, then we proceed to a third and final step, namely, resort to "appropriate maxims of construction." *Id.* at 364, 937 P2d 1019.

This three-step inquiry, based on *Yogman v. Parrott, supra,* appears to permit extrinsic evidence only after the court has determined that the agreement is ambiguous.

2. Case Law Supporting View That Extrinsic Evidence May Be Considered To Determine *Whether* A Contract Is Ambiguous

In *Abercrombie v. Hayden,* 320 Or 279, 883 P2d 845 (1994), the court held that a trial court "may consider parol and other extrinsic evidence to determine whether the terms of an agreement are ambiguous. ORS 42.220." *Id.* at 292.[1] (Emphasis added.) Whether this contradicted the court's decision in *Yogman v. Parrott* is discussed below.

3. Use Of Extrinsic Evidence To Show Separate Agreement

In *Abercrombie v. Hayden*, the court also considered the parol evidence rule and Oregon statutes to determine whether extrinsic evidence of an alleged oral agreement could be used to supplement a deed. The rule is equally applicable to change orders.

The parole evidence rule is found in ORS 41.740. A literal reading of the statute precludes all parol evidence, but the court has construed it as a codification of the common law rule, which permitted parol evidence in some situations. *Id.* at 286.

To determine whether parol evidence of a prior oral agreement may be considered, the court must first determine whether the writing in question is integrated or only partially integrated. The court may "consider all relevant evidence, including parol evidence" to determine whether the writing is a full or partial integration. *Id.*

A writing is "integrated" if the parties intended the writing to be "a final expression of some or all of the terms of the agreement." *Id.* A "partially integrated" writing is one "that the parties intended to be a final expression as to the terms in the writing, but *not* as to all the terms of their agreement." *Id.* (Emphasis in original.) If the agreement is not a complete integration of "some or all" of the terms of the agreement, extrinsic evidence is then admissible. *Id.*

Because a partial integration contains the final expression of some portion of the parties' agreement, the terms of the writing may not be contradicted. *Id.* at 289. However, it is permissible to supplement the agreement "by evidence of prior consistent, additional terms." *Id.* That prior consistent term must be given for a "separate consideration" or be one that "in the circumstances might naturally have been omitted from the writing. *Id.*

4. Disagreement About Application Of Extrinsic Evidence To Show Ambiguity

What remains an issue upon which the Ninth Circuit and the Oregon Court of Appeals disagree is whether extrinsic evidence can be introduced to determine if a contract is ambiguous (as *Abercrombie* states) or only after the court determines the contract is ambiguous (as *Yogman v. Parrott* and its progeny state).

The Ninth Circuit concluded *Yogman* implicitly overruled *Abercrombie. Webb v. National Union Fire Ins. Co, of Pittsburgh*, 207 F3d 579, 581-82 (9th Cir. 2000). In contrast, in a series of cases the Oregon Court of Appeals held the opposite. *See, e.g., Batzer Const., Inc v. Boyer*, 204 Or App 309, 129 P3d 773, *rev den,* 341 Or 366 (2006) (extrinsic evidence permitted to determine if contract is ambiguous).

Currently, the Oregon Court of Appeals has concluded that extrinsic evidence may be used in three circumstances to establish the terms of a written agreement:

> The rule does not exclude evidence of (1) "the circumstances under which the agreement was made, or to which it relates, as defined in ORS 42.220"; (2) "to explain an ambiguity, intrinsic or extrinsic;" or (3) "to establish illegality or fraud." ORS 41.470. *Batzer Construction, supra at* 314.

Meanwhile, the Ninth Circuit has not changed its conclusion that *Abercrombie* was overruled by *Yogman v Parrott*, but has stated that Court of Appeals cases would be given some

[1] ORS 42.220 provides: "In construing an instrument, the circumstances under which it was made, including the situation of the subject and of the parties, may be shown so that the judge is placed in the position for those whose language the judge is interpreting."

weight. *Arborieau v. Adidas-Alomon AG*, 347 F3d 1158, 1163 n. 4 (9th Cir. 2003) ("Our task, in a diversity case, is to predict what the Oregon Supreme Court would do when faced this with precise question. Intervening Oregon Court of Appeals cases would be pertinent to that task.")

Notwithstanding *Webb,* various judges on the federal district court have permitted extrinsic evidence at step one of the *Yogman v. Parrott* analysis. In *Fogg v. Wart*, 2006 WL 3716745 (D. Or. 2006), Judge Stewart stated that district courts are "bound by the Ninth Circuit's interpretation of Oregon law on extrinsic evidence" but concluded the court could examine extrinsic evidence "limited to the circumstances under which the contract was made" at step one of the *Yogman* analysis. Similarly, in *Principal Life Ins. Co. v. Robinson,* 2006 WL 508314 (D. Or. 2006), Judge Brown considered extrinsic evidence at step one of the analysis, but concluded no ambiguity was created.

B. Prior Oregon cases involving extrinsic evidence and change orders

Two significant Oregon cases concerning the use of extrinsic evidence to explain the meaning of change orders are *General Construction Co. v. Oregon State Fish Commission*, 26 Or App 577, 554 P2d 185 (1976), and *State v. Triad Mechanical, Inc.*, 144 Or App 106, 925 P2d 318 (1996). Because each case was decided before *Yogman v. Parrot*, they must be analyzed to see if they conform to current law on the interpretation of contracts.

In *General Construction Co.*, the contractor agreed to construct a fish ladder. The original plans and specifications contained errors regarding the existing dam against which the fish ladder was to be built, which resulted in new surveying and engineering work, thus delaying construction. 26 Or App at 186. The original contract contemplated that construction would be complete in one season before water overflowed the dam in the fall, but the errors pushed construction into the next year, after a portion of the ladder was built. After construction ceased, the overflow of water damaged the partially completed ladder. *Id.* at 187.

The next year, before the overflow of water ceased, the parties signed a change order that corrected the errors in the plans and specifications and increased the contract price by $19,646. The opinion neither provides the change order language nor describes in detail the changes for which payment was made, but the court stated it found the change order was silent in regard to whether the change order amount was the contractor's only remedy and was silent on whether the contractor had a right to collect additional damages. *Id.* at 187.

Later, the parties disputed whether the contractor could recover "all damages resulting from the delay by reason of the inaccurate specifications." *Id.* The State contended the change order was an "accord and satisfaction" and that the contractor had waived its right to collect additional money.[2] Nevertheless, the State admitted the impact of the changes totaled approximately nearly $550,000. *Id.* The contractor contended the change order represented the cost of just the specific changes listed on the change order and not the additional costs resulting from the inaccurate specifications.

The trial court considered extrinsic evidence to determine the parties' intent when executing the change order. The court found the parties had not discussed the amount of delay damages during their negotiations because the contractor was unaware at the time what that amount would be and concluded the change order did not preclude recovery of the contractor's additional costs. *Id.* at 189.

The second case, *State v. Triad Mechanical, Inc.*, concerned a contract to construct improvements to a hatchery. The

[2] An "accord and satisfaction" is another way of saying that the parties agreed (the "accord") that a substituted performance (the change order) would satisfy them in lieu of the originally requested performance (the original contract).

contract provided the contractor was entitled to an equitable adjustment of the contract price if more than 100 cubic yard of rock excavation was encountered. *Id.* at 109.

After more than 100 cubic yards of rock was encountered, the parties executed a change order that paid the contractor additional money for rock excavation and expressly provided that project completion time would not be increased. The change order made no reference to delay costs, referring only to the "direct costs of the extra rock removal." *Id.* at 111.[3]

After project completion, Triad submitted a claim for additional delay and impact costs associated with rock excavation; the State refused to pay. Triad contended the parties expressly discussed, but postponed consideration of, additional compensation for impact costs when the change order was signed; the State contended the change orders compensated Triad in full.

Triad did not claim the change order was ambiguous. *Id.* at 114 n. 8. Instead, it contended the parties had reached a separate understanding about delay costs that was not included in the change order and that it should be permitted to introduce evidence of that understanding.

That testimony could be allowed only if the parol evidence rule permitted it. First, the court found the parol evidence rule precluded Triad's proposed oral agreement in regard to contract time because the change order expressly stated it would not be increased. *Id.* at 116. Therefore, Triad could not contradict the change order with oral testimony that the State was willing to consider additional contract time at a later date.

Second, the court found the parol evidence rule precluded Triad's proposed oral agreement in regard to additional compensation for delay costs because it was not the type of agreement that the parties "might naturally have omitted from the change orders." *Id.* at 118.

To support its conclusion that the claim for additional compensation was one that would not have been omitted from the change order, the court noted that: a) this was a sophisticated business transaction; b) the parties had prior business experience; c) the contractor had familiarity with the change order procedure; d) the contractor had knowledge that the additional excavation would require additional time and additional cost, or both, at the time the change order was executed; e) delay costs were discussed with the State at the time of the change order was discussed; and f) the change order did not preserve the claim for delay costs. *Id.*

C. Analysis

The use of *General Construction Co.* as legal precedent is problematic because the case a) does not discuss the parol evidence rule, b) does not discuss whether the change order was ambiguous, and c) fails to state the standard for review by which the court reviewed the trial court's rulings.

In addition, *General Construction Co.* failed to provide the exact language of the change order upon which extrinsic evidence was considered. Therefore, it is difficult to state that *General Construction Co.* followed the most recent rules of contract interpretation. *Triad Mechanical's* refusal to cite *General Construction Co.* as authority for its decision is another reason to consider the earlier case analytically suspect.

In contrast, *Triad Mechanical* appears to follow the court's analytical path in *Abercrombie v. Hayden* to determine whether extrinsic evidence of an oral agreement would be admissible.

An important aspect of the parol evidence rule is the responsibility of the court to determine whether an alleged oral agreement "would naturally have been omitted" from the change order before the court. This requires a judgment call on the part of the court and places responsibility on the parties to establish facts that would support a conclusion in their favor.

[3] There were actually two change orders, but only because the first one contained a typographical error. For ease of discussion, only the correct change order is discussed.

Even so, the court may reach a different conclusion based on the same evidence. For example, in *General Construction Co.* the court stated:

> * * * at the time of the change order, the delay damages could not have been fully determined at the time of the change order since water was still overflowing the previous season's work. *Thus the parties could not have considered those damages at that time*. 26 Or App 577, 583. (Emphasis added.)

In contrast, in *Triad Mechanical*, a contractor's knowledge that undetermined costs would be incurred was a reason to reject extrinsic evidence. Thus, silence of the change order on delay and impact costs in *General Construction* favored the contractor, but the same facts favored the owner in *Triad Mechanical*.[4]

Given disparate conclusions, the best approach is to advise clients that change orders should be crystal clear to avoid putting their fate into the hands of third parties (such as judges) who may come to reasonable, but different, conclusions based on similar facts. Rather than argue what might "naturally" be included in a change order to a judge, a contractor or owner should explicitly recite not only what matters are addressed by the change order but also should explicitly preserve (or waive) the contractor's right to additional damages. Reliance on silence puts one at the mercy of the court's most recent understanding of how "natural" that omission might be.

D. Summary

In summary, a lawyer faced with a change order in dispute should consider the following:

1. Is the change order ambiguous?

> *The court determines whether the contract is ambiguous as a question of law. Yogman, supra; Abercrombie v. Hayden*, *supra* at 291.

2. The court may consider extrinsic evidence to determine whether the change order is ambiguous and supports the client's position.

> *ORS 42.220 permits the judge to consider "the circumstances under which it was made, including the situation of the subject and of the parties." Accord: City of Eugene v. Monaco, 171 Or App 681, 687, 17 P3d 544 (2000), rev den, 332 Or 240 (2001) (Extrinsic evidence to be considered is "limited to the circumstances under which the agreement was made.")*
>
> *However, the type of evidence that qualifies to show the "circumstances under which the agreement was made" is "less than clear." Nixon v. Cascade Health Services, Inc., 205 Or App 232, 241 n.10 134 P3d 1-27 (2006)*.

3. If the court determines the agreement is ambiguous the question of what the agreement means is for the finder of fact. *Abercrombie v. Hayden, supra,* at 292.

> *Parol and other extrinsic evidence is admissible to help the jury determine the meaning of the ambiguous terms. Id.*

4. If it is asserted that the parties reached a separate oral agreement prior to the time the change order was executed, the first issue is whether the agreement is integrated or partially integrated.

> *The court determines whether the agreement is integrated or partially integrated. Abercrombie v. Hayden, supra.*

5. If the court determines the writing is fully integrated, it may not be "contradicted or supplemented by prior terms." *Abercrombie v. Hayden, supra,* at 288.

[4] Indeed, the dissent in *Triad Mechanical* concluded that the oral agreement to discuss delay costs at a later date was not one that would naturally have been included in the change order.

6. If the court determines the writing is "partially integrated," the writing may not be contradicted, but it may be supplemented by prior, consistent additional terms that were either a) agreed upon for separate consideration, or b) were terms as "in the circumstances might naturally be omitted from the writing." *Id.* at 289.

> *The court determines whether the terms might naturally have been omitted from the writing. Abercrombie v. Hayden, supra*.

These steps strengthen the conclusion that change orders must be carefully drafted to avoid later confusion, disputes and claims that the change order was not a complete resolution of the impacts of the changed work.

WHAT IS SUBGUARD? DIFFERENCES BETWEEN PERFORMANCE BONDS AND DEFAULT INSURANCE

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Depending on the nature of the project, and the delivery history of the contractor, many lenders require borrowers to obtain a performance bond from their contractor on larger projects. Over the last decade an alternative to such bonds has become available. This alternative is generally known as "Subguard."

Subguard is a proprietary term for Zurich North America Insurance Company's subcontractor default insurance policy. Because it was the first policy of this type, the name has become a somewhat generic label for the type of coverage the policy provides.

Designed as an alternative to bonding contractors, default insurance is first-party insurance that compensates the insured in the event a covered contractor or subcontractor fails to fulfill its contractual obligations. Insureds are generally required to develop and implement contractor prequalification procedures and to retain a percentage of losses.

This coverage is best suited for large projects constructed by regional general contractors with a significant percentage of subcontracted work and established relationships with subcontractors. These elements (general contractor profile and amount of subcontracted work) are what usually determine the pricing associated with the policy. Typically, default insurance cost less than performance bonds.

A default insurance policy, like other polices of insurance, provides the insured only with monetary compensation upon the occurrence of a default. Unlike performance bonds, it does not insure completion of the project and thus the risks to the lender differ from those associated with bonded work. A closer examination of the general contractor and its ability to complete the work in the event of a subcontractor default is therefore merited. The risk associated with failure by the prime contractor is, to some degree, priced out of default insurance.

Default insurance has a number of benefits:

- No delay associated with surety analysis or takeover
- Indemnification for direct and indirect costs resulting from default in performance of any subcontractor on projects the policyholder chooses to cover
- Broad coverage for all enrolled subcontractors and suppliers that qualify under the contractor's own prequalification system
- Full policy limits available for each loss regardless of subcontract amount
- Multiyear programs consisting of annual policies

Default insurance also has drawbacks:

- Usually a claims-made policy
- High deductibles
- Need to prequalify subcontractors and suppliers, a task usually performed by the surety when performance bonds are utilized
- Limited remedies
- Generally limited to projects in excess of $50,000,000

Default insurance can be an effective means of controlling the risks associated with subcontractor performance as well as corresponding delay to the project. However, it leaves the contractor, and possibly the owner, exposed to the risk of unreimbursed expense and an incomplete project. Deciding whether to proceed with a performance bond or default insurance is a project-specific decision.

BUILDER BEWARE: FAILURE TO PAY A JUDGMENT FOR A CONSTRUCTION DEBT CAN JEOPARDIZE THE LICENSE OF A CONTRACTOR'S OTHER BUSINESS

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A contractor that owns more than one company licensed with the Construction Contractors Board ("CCB") faces a unique challenge when one of those companies owes a debt on a judgment arising out of defective construction work. Not only can the CCB revoke the license of the debtor company if the judgment is not paid, it can also revoke the license of the company that does not owe the debt.

The relevant language is in ORS 701.102:

> "(2) The Construction Contractors Board may revoke, suspend or refuse to issue a license required under this chapter to a business if:
>
> ***
>
> (c) An owner, officer or responsible managing individual of the business was an owner, officer or responsible managing individual of another business at the time the other business incurred a construction debt that is owing or at the time of an event that resulted in the revocation or suspension of the other business's construction contractor license."

A "construction debt" is defined as "[a] final order or arbitration award issued by the board" or "[a] judgment or civil penalty arising from construction activities within the United States." ORS 701.005(2)

This statute provides a powerful tool for the CCB to ensure that contractors pay their debts. The law makes it difficult, if not impossible, for a contractor to simply cease the operations of one company that owes a debt and continue operations through another company or start a new one, free of the debtor company's obligations. If the debt cannot be paid, the contractor may end up going out of the construction business completely. And that is precisely what the CCB seeks to do in some instances – get the supposedly "bad contractor" off the streets to avoid further potential harm to the public.

The options for avoidance of this type of license revocation are few. It is unclear whether placing the debtor company in a Chapter 11 bankruptcy would provide adequate protection.

In *In re Ray*, Bankruptcy No. 05-71986 FRA7, Adversary No. 06-6025-fra (Nov. 29, 2006), the court held that on federal preemption grounds, the CCB could not refuse to issue a new license to a former principal of a company that had failed to pay its construction debts, where the principal sought to start a new company after the discharge. In *Ray*, the principal had personally guaranteed the obligations of the debtor company, and the principal had filed a Chapter 7 bankruptcy.

In its decision, the court made clear that the holding was limited to the facts of the case, thereby leaving for another day whether the CCB would similarly be preempted from revoking a non-debtor company's license, or refusing to issue a new one, in any other situation. Thus, there presently is no case holding that the CCB is prevented from exercising its powers under ORS 701.102 where the debtor company itself has filed for bankruptcy.

A second option to avoid a license revocation is to agree to a payment plan with the judgment creditor. Where a contractor lacks the funds or immediate ability to agree to a plan, however, this option may not be feasible. The statute allowing revocation of the license of a separate construction company can compound the

situation by preventing the contractor from having any ability to enter into such a plan by working off the debt through another company.

A third, perhaps lesser-known option is to change the principal of the company to one who is acceptable to the CCB. In the CCB's eyes, it is often a particular person who is the "bad guy," so that if another, presumably more responsible person takes over operations, the CCB's concerns will be alleviated. Of course, this means that a person who has run his own business for decades may have to turn over the reins to someone else. If no one trustworthy can be found, this option may not be workable.

One could question the wisdom of a rule that can prevent a person from pursuing a living in a career that may be the only work the person has ever known. Even long-standing, reputable contractors can get caught in a revocation proceeding during an economic downturn, such as is occurring now, with little or no ability to immediately begin paying on an outstanding construction debt. Revocation of the contractor's other business's licenses, or refusal to issue a new one, means not just that the contractor goes out of business, but also that the creditor never gets paid. For these reasons, it is extremely important that the CCB exercise its discretionary powers with care.

CONSTRUCTION LIENS AND BANKRUPTCY

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Construction lien holders must comply with strict time limits to maintain or enforce their rights. The periods for giving notice of recording a construction lien, giving notice of intent to foreclose and filing a lawsuit for foreclosure of a lien are examples of those deadlines. When an owner, general contractor, subcontractor or supplier files for bankruptcy protection, the intersection of bankruptcy rules and construction lien rules can create a confusing situation.

Most collection efforts and attempts to create, perfect or enforce a lien are automatically stayed (the "Automatic Stay") once a debtor files a bankruptcy petition. However, as mentioned above, strict time frames and deadlines under state law can make the difference between perfecting and enforcing construction lien rights and obtaining attorney fees and other costs for the enforcement of those claims. Fortunately, an exception to the Automatic Stay allows a contractor or supplier to file a construction lien without obtaining relief from the Automatic Stay.

Under Oregon law, a lien holder must give notice to the owner and any mortgage or trust deed lender of the recording of the construction lien within 20 days after such recording. That notice, along with a later required 10 day notice of intent to foreclose, preserve the right of the lien claimant to recover cost, disbursements and attorney fees in a lawsuit to foreclose the lien. It is not uncommon for both notices to be contained in one document.

However, such notices to a bankruptcy debtor are arguably prohibited by several subsections of the Automatic Stay rules. The exception mentioned above for filing construction liens may well not apply because those statutes only relate to perfecting, maintaining or continuing perfection of the lien, while the notice of recording of the construction lien and the notice of intent to foreclose the lien only relate to the right to recover costs, disbursements and attorney fees. Thus, in order for the contractor or supplier asserting the lien claim to preserve its rights to costs, disbursements and attorney fees, it must move for and obtain for relief from the Automatic Stay within the time frame set forth under state law. The Automatic Stay rules under the bankruptcy code also allow for a party to request emergency relief from the Automatic Stay if time is short.

Commencing a foreclosure lawsuit is prohibited by the Automatic Stay. However, several options are available to protect a creditor who faces a deadline to file a foreclosure lawsuit. Pursuant to a 9th Circuit Court of Appeal case, *In re* Hunters Run Limited Partnership, the time for a construction lien claimant to file its construction

lien foreclosure case is tolled as long as the bankruptcy is pending (and likely 30 days thereafter). Nonetheless, a careful lien claimant may not wish to rely only on a 9th Circuit case.

Alternative protection is available under Bankruptcy Code Section 546(b), which provides that if some action must be taken to maintain or continue perfection of an interest in property of the debtor, that claim shall be perfected, or the perfection shall be maintained or continued, by giving notice within the deadline for taking the action needed. Thus, without obtaining relief from the Automatic Stay, the lien claimant can file with the bankruptcy court within 120 days of recording of the construction lien, a notice under Section 546(b). A copy of the notice must also be sent to the debtor in possession or the trustee and to other interested parties, including any owners and mortgage or trust deed holders.

One additional action is available if the lien claimant decides to leave no stone unturned. The lien claimant can move for relief from the Automatic Stay to file the lawsuit. The bankruptcy court is likely to authorize filing of the lawsuit in state court, in order for the lien claimant to maintain its rights and remedies under Oregon law, so long as the state court foreclosure suit is then stayed pending resolution of the claims in the bankruptcy court. This action probably offers the ultimate protection.

Although a bankruptcy may be frustrating to a lien claimant, it does not have to result in any loss of rights or remedies. Careful navigation through bankruptcy laws and construction lien laws is the key to a successful resolution.

CONSTRUCTION LIEN SERVICES AND THE UNAUTHORIZED PRACTICE OF LAW

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There are seven or eight advertisers under 'Lien Services' in the Portland Metro Dex Yellow pages. One of them, the BMDA, limits its services to the filing of Notices of Right to Lien, and its web site states:[1]

> At BMDA, we believe attorneys who specialize in construction lien law are your best choice for preparing lien documents. Therefore, if you have legal questions or wish to file a construction lien, we offer attorney referrals in Oregon and Washington. BMDA will not provide legal advice at any time.

On the other hand, Northwest Lien Service's web site states:[2]

> We provide support to the construction industry in Washington State by preparing *Notices of Intent* and *Liens* quickly and accurately for busy contractors. * * *. Our services in many cases can eliminate the need to hire an attorney.

The website of The Building Bureau, in Woodland, Washington, expressly contemplates preparation and filing of liens in Oregon,[3] and represents:

> At The Building Bureau we are experts in the lien service industry.

All experienced construction lawyers have seen construction liens prepared and filed by lien services. Some are adequate, but many are not. The difficulties with application of construction lien law are well stated in an Illinois Supreme

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1 http://www.bmda.com/about_us.htm.

2 http://www.northwestlienservice.com. Another page of the web site states "Attorney available at NO CHARGE!"

3 http://www.thebuildingbureau.com

Court decision allowing a claim for 'lien service malpractice,' which accurately parallel the situation in Oregon:[4]

> Plaintiffs' failure to be aware of an alleged defect is understandable given the technical and complex nature of Illinois law regarding mechanics liens. Plaintiffs, as laymen, could not be expected to identity defects in a mechanics lien that would lead to a substantial reduction in the lien. Plaintiffs would have no reason to know that the lien was improperly prepared until they actually sought to enforce the lien. Plaintiffs would have no reason to know that they were injured or that this injury was wrongfully caused until they attempted to enforce the mechanics lien.

Even the dissent rejecting the concept of 'lien service malpractice' - discussed below - agreed that lien law is beyond the skill of laymen:

> . . . [A] substantive and procedural knowledge of the law of mechanics liens is necessary to appreciate the lien claim here. The lien claim, though clearly stated, is insufficient under existing law to create the right it purports to establish. * * * I do not dispute the "technical and complex" nature of the law of mechanics liens.

Lien services undoubtedly prepare liens at less expense than attorneys, but, at what cost to the industry? At least in Oregon, most malpractice related to liens occurs before and at the time of filing in the county records and becomes incurable seventy five days after the lien claimant's last work. Even experienced lawyers can make mistakes in the filing of construction liens, especially those filed 'at the last minute.' This is exacerbated by the well known propensity of county recording officers to reject filings on the basis of technicalities or misunderstandings of the law as it relates to liens (*i.e.*, laxity in legal descriptions).

It is always unpleasant to litigate defenses to liens, priority problems, or issues about entitlement to attorney fees involving a lien that your own office prepared. One can sometimes get the feeling: A lot of trouble can be saved if the lien is filed by a lien service - all the damage is done before the case even reaches my office.

Should it matter, because most construction liens are simple and are not screwed up by lien services, and most liens are paid without foreclosure, that even defective liens achieve their purpose and therefore most lien service malpractice is harmless? On the other hand, experienced construction lawyers know that when a construction lien is defective in terms of allocation, priority or enforceability, great harm can accrue to the unfortunate lien claimant. What level of lien service malpractice should be tolerated simply because there is a demand for a low cost service?

A collateral concern, which this article addresses, is: Is it legal for lien services to prepare construction liens in Oregon? Are lien services committing the unlawful practice of law in preparing construction liens? Would lawyers benefit from exclusion of lien services from the market for preparation of construction liens? Would the industry benefit? What segment of the industry?

Every other state that has addressed the question has held that non-lawyers violate UPL,[5] although as the discussion below will show, the two dissenters in *Hermitage Corporation*, *supra*, probably would have held that preparation of liens was not UPL.

In *Stewart Abstract Co. v. Judicial Commission of Jefferson County*, 131 SW 2d 686 (Tex Civ App 1939), a title company - a corporation - was held to be unlawfully practicing law, even though the work was done by staff

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4 *Hermitage Corporation v. Contractors Adjustment Service*, 166 Ill 2d 72, 651 NE 2d 1132 (1995).

5 In most states 'Unauthorized Practice of Law,' but in Oregon, 'Unlawful Practice of Law.'

lawyers. One of the acts mentioned was the preparation of mechanics' liens, but the case did not turn specifically on whether the preparation of liens was UPL.

In *Florida State Bar v. Carmel*, 287 So 2d 305 (Fla 1973), Carmel was a non-lawyer specializing in advising clients both in filing and resisting liens. The Florida State Bar sought an injunction and contempt against Carmel for:

- advertising to the general public to perform services of preparing, filing and releasing mechanics and materialman's liens on property,

- providing a so called "kit" to customers with information on legal rights concerning mechanics liens with advice on when, how and where to file and their legal effect,[6]

- advising as to the time for notice and other procedural law relating to mechanics lien and preparing and signing as agent notices of commitment, claims of lien and releases,

- upon failure by builders to pay customers, writing letters for the customers threatening to file liens and signing as agent of the customer,

- actually preparing, signing and filing certain liens, and

- searching public records to obtain information of claims and liens, ascertaining whether legal description matched street address and other information on property in order to advise customers on how to best protect their legal rights under the lien law.

In defense, Carmel contended, among other things:

- the acts alleged constituted solely mechanical acts not requiring legal training or a license to practice law,

- that no legal judgments or opinions were made or offered and that any citizen had the right of access to public records including all public documents of record,

- that the collection of delinquent accounts is not a legal matter per se and Carmel did not file suit or represent parties in judicial proceedings,

- that it was not the practice of law to charge for services such as looking up legal descriptions, preparing and filing notices to owners or liens under the lien law, or collecting delinquent debts,

- that the legislation establishing lien rights contemplated that they would be filed by lay persons as do the statutory forms prescribed by law,[7]

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6 In Oregon, this would not by UPL, nor would advertising generic publications providing legal advice. Selling do-it-yourself books, forms, etc., including generic advice about how to fill them out, without individualized contact or crafting, is lawful, *Oregon State Bar v. Gilchrist*, 272 Or 552, 538 P2d 913 (1975); *Oregon State Bar v. Smith*, 149 Or App 171, 181-82, 942 P2d 793 (1997). Selling a 'law course' is also lawful, *State ex rel Oregon State Bar v. Wright*, 280 Or 713, 719, 573 P2d 294 (1977).

7 In Oregon, only the Notice of Right to Lien, *see*, ORS 87.021(1) and (2) and 87.023, and the Information Notice to Owner, ORS 87.093, are statutory or semi-statutory forms. While there are standard construction lien forms prepared by the Stevens Ness Law Publishing Company, they are simply the publisher's effort to prepare a form generally in compliance with the statute and do not address many of the issues which make preparation of liens so complex.

This is all in contrast to public works bond claims, for which there is a statutory form, ORS 279C.605(3). In the State of Washington, not only are the pre-lien notice forms statutory, RCW 60.04.031(4) and ORS 60.04.221(4), but there is a statutory form for the mechanics lien itself, RCW 60.04.091(2). That is not to say that the Washington lien law is any less complex, but, there is no question about what form is sufficient for the lien.

- that historically, banks, trust companies, title companies, trade associations, bookkeepers, accountants, credit managers and others performed the same acts without a license to practice law and not contrary to the public welfare,

- that Carmel performed only specific acts for which a specific charge was made, including the filing of a claim of lien which is a recorded instrument, pursuant to written consent from the customer,

- that there was no irreparable harm to the public, and

- that a layman specializing in a single task can often perform that task better and more economically than a professional.

The Florida Supreme Court summarily held the conduct alleged was the unauthorized practice of law, issued an injunction, and stated that if the injunction was violated, Carmel would be held in contempt.

The same type of operation was the subject of *Crain v. The Unauthorized Practice of Law Comm. of the Supreme Court of Texas*, 11 SW 3d 328 (Tex App 1999). Crain, a non-lawyer, operated Credit Management Consulting Company, which collected debts related to the construction industry. It prepared, signed and filed lien affidavits on behalf of laborers, and caused the affidavits to be filed for record. The UPLC sought and obtained an injunction from the trial court enjoining Crain and his company from, among other things:

- engaging in any practice constituting the practice of law;

- preparing, charging, or receiving any compensation for the preparation of legal instruments affecting real property, including a mechanic's lien, materialman's lien, release of lien, or lien affidavit and claim;

- the continuation of any ongoing or new lien notices, release of lien preparation, lien affidavit and claim preparation or filing, and negotiations with home owners, lienees, potential lienees, and insurance companies;

- advertising that they possessed the ability to collect money for claimants by the use of notices of intention to file liens or lien affidavits,

- supplying legal forms to third parties, including forms for the preparation of a mechanic's lien, materialman's lien, release of lien, or lien affidavits,[8] and

- providing advice to third parties regarding completion or filing of such forms or documents.

The Texas Court of Appeals affirmed. Having in mind the Texas definition of the practice of law,[9] which is very similar to Oregon's definition, the Court rejected the contention that lien preparation was not the practice of law:

> The uncontroverted facts in this case reveal CMCC was engaged in the unauthorized practice of law. CMCC prepares and files lien affidavits and claims and releases of liens, legal instruments affecting title to real property. The preparation of these documents involves the use of legal skill and knowledge. In preparing these documents, CMCC impliedly advises its clients of their legal rights and entitlement under the law. CMCC also prepares and sends letters to property owners interpreting home owner insurance policy provisions and advising them to make a claim against their title insurance policy in furtherance of perfection of the legal rights of its clients. When CMCC sends such letters to

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[8] This particular activity would not be UPL in Oregon, *Oregon State Bar v. Gilchrist*, *supra*; *Oregon State Bar v. Smith*, *supra*.

[9] [T]he preparation of a . . . document . . . as well as a service rendered out of court, including the giving of advice or the rendering of any service requiring the use of legal skill or knowledge, such as preparing a[n] . . . other instrument, the legal effect of which under the facts and conclusions involved must be carefully determined.

home owners, it impliedly advises them that they do in fact have legal rights and should make a claim. CMCC engages in these tactics to procure settlements with insurance companies in exchange for release of liens. Settling claims secures an individual's legal rights with respect to such claims, and involves the use of legal skill and knowledge.

* * *

Viewing the facts most favorably to CMCC and resolving all doubts in its favor, we conclude CMCC's activities constitute the unauthorized practice of law. We hold the trial court properly rendered summary judgment permanently enjoining CMCC from continuing such practices.

Finally, in State Bar of Arizona UPL Advisory Opinion 04-01,[10] it was held:

- the preparation, service and recording of mechanics lien notices is the practice of law, because lien notices are intended to secure legal rights for the contractor and are filed with the county recorder,

- a contractor may prepare, serve and record mechanics lien notices to secure mechanics liens relating to its own work, if that is incidental to its regular business, for use in that business, and not for third parties, and

- a third party may not prepare, serve and record mechanics lien notices for contractors for a fee, unless the work was done by a certified document preparer.[11]

Oregon has not addressed the question directly. However, in similar cases involving non-lawyers providing advice about complicated areas of the law, the Oregon Supreme Court has found UPL.

In *Oregon State Bar v. Miller*, 235 Or 341, 344-45, 385 P2d 181 (1963), involving the preparation of estate plans by an insurance business, the court said: "Much of the advice contained in the report to the client could not be given without an understanding of various aspects of the law, principally the law of taxation. Most of the advice is in terms of "suggestions." In each instance the client is urged to consult his own attorney. But whether the report takes the form of suggestions for further study or as a recommendation that the suggestions be subjected to further scrutiny by a lawyer, the fact remains that the client receives advice from defendants and the advice involves the application of legal principles. This constitutes the practice of law. * * * To fall outside the proscription of the statute the legal element must not only be incidental, it must be insubstantial."

In *In re Morin*, 319 Or 547, 562-64, 878 P2d 393 (1994), the court held that where a lawyer's paralegal employees gave general lectures about estate planning, that was not the practice of law, but where the paralegal examined and interpreted wills and advised clients on courses of action was the practice of law.

Section 20.1(B) of the OSB Bylaws states that

> 'unlawful practice of law' means the practice of law, as defined by the Oregon Supreme Court, by persons who are not members of the Bar and are not otherwise authorized by statute do so. * * * The practice of law includes, but is not limited to, any of the following: * * * appearing, personally or otherwise, on behalf of another in any judicial or administrative proceeding or providing advice or service to another on any matter involving the application of legal principles to rights, duties, obligations or liabilities.

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10 http://www.myazbar.org/LawyerRegulation/upl/uplaa0401.pdf. "Opinions of the Committee are advisory in nature only and are not binding in any disciplinary or other legal proceedings."

11 Arizona has authorized certain legal document preparation to be performed by 'certified legal document preparers,' Arizona Code of Judicial Administration § 7-208. Oregon has no equivalent.

Numerous cases from the Oregon Supreme Court and Oregon Court of Appeals have also defined the practice of law, using definitions very similar to that of the OSB Bylaws. *See, e.g.*, *Oregon State Bar v. Smith*, 149 Or App 171, 183, 942 P2d 793 (1997) ("Most significantly, for present purposes, the "practice of law" means the exercise of professional judgment in applying legal principles to address another person's individualized needs through analysis, advice, or other assistance").

Just some of the reasons that preparation of construction liens in Oregon requires skilled and individualized legal advice (every experienced construction lawyer can add to this list) include, not in any particular order:

- consideration of whether particular work or material is lienable,
- if there is any question as to lienability or other technicalities, the method of segregation,
- methods of describing the property subject of the lien especially where liens are filed at the last minute or when final plats have not yet been recorded,
- numerous problems related to blanket liens,
- method of assertion of rights to finance charges,
- segregation of labor and materials and other issues to ensure maximum priority,
- proper methods of service to perfect the right to recover attorney fees, including advice about dealing with ORS 87.057 demands,
- analysis of ambiguous lien waivers,
- education of lien claimants about intentional overstatement and other 'no-no's, and
- proper signature and verification.

Quare: Can a lien service be sued for malpractice? It is horn book law that a person holding himself out as qualified to perform professional services is held to the professional standard of care, has the same malpractice liability as a lawyer. *Buscemi, J.D. v. Intachai*, 730 So2d 329 (Fla App 1999) (upholding $675,000 verdict against non-lawyer for malpractice); *Brown v. Shyne*, 212 NY 176, 151 NE 2d 197 (1926) (chiropractor held to the standard of care of a medical doctor).

A lien service was sued for malpractice in *Hermitage Corporation v. Contractors Adjustment Service*, 166 Ill 2d 72, 651 NE 2d 1132 (1995). The mechanics lien was prepared for the claimant, a plumbing contractor, that worked on a 72-unit condominium. The face amount of the lien was about $93,000. At trial, the lien was reduced to about $17,000, because the lien claim was not properly allocated between the condominium units, nor did the lien state when the work was performed.

The plumbing contractor sued the lien service for negligence, negligent and unauthorized practice of law, consumer fraud and breach of warranty. The lien service moved to dismiss the claims on the basis of the statute of limitations. The trial court denied the motion; the Illinois Court of Appeals reversed, and the Illinois Supreme Court reversed a portion of the Court of Appeals decision, remanding for trial all the counts except the consumer fraud claim. The majority opinion applied the discovery rule and entirely glossed over the question of whether the lien service could be held liable for malpractice. However, the issue was apparently decided, because the dissent took the position that the discovery rule did not apply where there was no professional relationship and thus no tort duty:

> A non-attorney who undertakes, pursuant to a simple personal service contract, to claim a lien for another does not, under Illinois law, owe duties akin to those owed by an attorney. * * * The more far-reaching consequence of the court's decision is the elevation of a non attorney's ignorance of law to the status of legal malpractice. * * *
>
> Furthermore, by licensing attorneys and policing the profession, this State, explicitly

> and implicitly, justifies a client's reliance on an attorney's competence to create legal rights like liens. Not so with respect to the non-attorney who purports to do the same thing. The law does not hold the non-attorney to any standard of legal expertise. In contracting with a non-attorney for services in creating a legal right such as a lien, the "client" is not similarly justified in freely relying on the non-attorney's competence. Unfortunately, that leaves the "client" at risk of not being able to appreciate, for himself, a legal injury arising from the "legal" services in time to hold the non-attorney responsible.
>
> Such misfortune is not, however, reason enough to recognize a cause of action for legal malpractice against all non-attorneys whose contractual services are intended, but fail, to create legal rights. In roundabout fashion, that is precisely the effect of the court's application of the discovery rule today. I cannot agree with that result.

We also know that most lien services require users to acknowledge that the lien service is not a lawyer and to waive prospective liability. Certainly, such a waiver would be a violation of a lawyer's professional ethics, State of Oregon Formal Ethics Opinion 2005-61. Whether the rule is one of substance and not only one of ethics has not been addressed in Oregon.[12]

[12] The question was raised, but not answered, with respect to engineers, in *Estey v. McKenzie Engineering Inc.*, 324 Or 372, 376, 927 P2d 86 (1996).

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