Construction Law Newsletter

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IN MEMORIAM: ART TARLOW

It is with sadness that we note the passing of Art Tarlow, one of our Section's longest-standing members.

Art was born in Portland, Oregon on March 15, 1942. Art finished his undergraduate degree at the University of Oregon and graduated from the UO Law School and became a member of the Oregon State Bar in 1966. Art served in the Army in Vietnam and Europe and upon his return to Portland, was a deputy district attorney for Multnomah County under George Van Hoomisen.

Art entered civil law practice in Beaverton in 1970 and practiced with several successful law partnerships. In 2001, he formed Tarlow, Naito & Summers, LLP with Steve Naito and Brent Summers. When he died on June 10, 2010, Art was a member of the Oregon and Washington Bars, and he had tried or settled cases in Alaska, Arizona, California, Colorado, Delaware, Hawaii, Idaho, Illinois, Michigan, Nevada, New Mexico, New York, North Dakota, South Dakota and Texas.

Art served on many public and private boards of directors, including the Rose Festival Association, Oregon Mortgage Bankers, Beaverton Area Chamber of Commerce and Oregon Title Insurance Company. Art was a member of the Associated General Contractors of Oregon for more than 25 years. He published several articles and presented papers for the AGC, other trade and industry groups, the Oregon State Bar and other continuing legal education providers on construction law and mediation. Art always tried to bring a business-like approach to law practice and it served him, his partners, the people he mentored and his clients very well.

Please send remembrances to "The Art Tarlow Memorial Scholarship Fund" c/o Tarlow, Naito & Summers, LLP, 150 SW Harrison, Suite 200, Portland, Oregon 97201.

2010 CASE LAW & STATUTES UPDATES

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A. AFFIRMATIVE DEFENSES/ COMPARATIVE FAULT

A defendant in an action for breach of an express warranty under the UCC may introduce evidence that the plaintiff caused the damages.

Taylor v. Ramsay-Gerding Construction Co., 233 Or App 272, 226 P3d 45 (2010).

Third-party defendant ChemRex, Inc., supplied stucco for a hotel construction project and provided a five-year warranty. At trial, the jury found that ChemRex had breached the warranty, resulting in $775,000 worth of damages to plaintiffs. ChemRex, however, had asserted an affirmative defense that the damages were caused by plaintiffs' own negligence or the negligence of others. The trial judge allowed the defense to go to the jury, and the jury apportioned the fault between plaintiffs and ChemRex 49-51 percent. The trial court reduced

plaintiffs' judgment by the percentage that plaintiffs were at fault.

In the original appeal of the trial court's decision, ChemRex argued that the trial court had erred by denying ChemRex's motion for directed verdict against the breach-of-warranty claim. ChemRex contended that there was insufficient evidence for the jury to decide that ChemRex's territory manager had the apparent authority necessary to give plaintiffs the express warranty at issue. *Taylor v. Ramsay-Gerding Construction Co.*, 215 Or App 670, 679, 681, 172 P3d 251 (2007) ("*Taylor I*"). The court of appeals agreed with ChemRex, rendering moot other assignments of error complained of by plaintiffs and ChemRex, including plaintiffs' cross-appeal that the trial court had erred by submitting ChemRex's comparative-fault defense to the jury. The Oregon Supreme Court then reversed the court of appeals, holding that there was sufficient evidence on the apparent-authority issue. *Taylor v. Ramsay-Gerding Construction Co.*, 345 Or 403, 406, 196 P3d 532 (2008). The Oregon Supreme Court remanded the case to the court of appeals so that it could rule on the other assignments of error originally rendered moot by the decision in *Taylor I*.

On remand, the court of appeals considered whether it was error to allow the jury to consider evidence of plaintiffs' comparative fault when deciding the breach-of-warranty claim. Ultimately, the court of appeals held that evidence of comparative fault was relevant and proper for a jury to consider in a breach-of-warranty claim subject to the Uniform Commercial Code (the "UCC"). But the court of appeals also clarified that it did not decide whether the trial court had erred in reducing plaintiffs' damages by the portion of plaintiffs' fault because it was not an issue framed by plaintiffs' appeal.

Plaintiffs argued that, as in a breach-of-contract claim, comparative fault does not apply in a breach-of-express-warranty claim. ChemRex responded with several counterarguments, including that (1) ORS 31.600 requires plaintiffs' damages to be reduced by their percentage of fault whether or not plaintiffs' injury was in tort or contract; (2) contributory negligence is a defense to a breach-of-express-warranty claim at common law; and (3) under the UCC, comparative negligence is relevant to determine the amount of damages proximately caused by ChemRex's breach.

Addressing ChemRex's UCC argument only, the court of appeals held that it was not error for the jury to consider evidence of plaintiffs' comparative fault. When a seller provides goods that are not as warranted, ORS 72.7140 allows the buyer to recover the difference between the value of the goods accepted and the value of the goods as warranted, incidental damages, and consequential damages. Consequential damages under ORS 72.7150(2)(b) include injury to property proximately resulting from the breach, but do not include losses caused by the buyer or losses that the buyer could have prevented. Thus, although no UCC provision expressly requires that a seller's liability for breach of warranty be reduced by the buyer's or some third party's contributing wrongful conduct, the seller can be liable only for damages that it proximately caused.

Viewing the allegations of plaintiffs' complaint, the court of appeals determined that the damages sought by plaintiffs—the value of remediation and repair of the building—were primarily consequential damages for UCC purposes. Accordingly, it was incumbent on plaintiffs to show that their damages had been proximately caused by ChemRex's breach. And ChemRex was entitled to present evidence—whether labeled as comparative fault or alternative causation—to show that the losses had been proximately caused by plaintiffs or others and not ChemRex. Thus, it was not error for the trial court to submit evidence to the jury concerning plaintiffs' fault.

B. APPEAL AND REVIEW

Procedurally, a party wishing to preserve for appeal the trial court's refusal to send an issue to the jury must object after the court rules that the issue will not go to the jury, even if the party has raised the issue previously.

Taylor v. Ramsay-Gerding Construction Co., 235 Or App 524, 230 P3d 45 (2010).

After remand from a number of appeals concerning mainly the apparent authority of a territory manager to create an express warranty under the UCC for stucco in a construction defect action, and the admission of evidence of comparative fault in defense of the breach-of-warranty claim, the court of appeals reconsidered two additional issues.

First, defendant asserted that it was entitled to directed verdict against the breach-of-warranty claim because—notwithstanding the district manager's apparent authority to create a warranty—the warranty was not a part of the bargain because it was made after plaintiff's agreement to buy the product. The court of appeals refused to disturb the jury's verdict that a warranty was created because there was evidence in the record to support the conclusion.

The second issue was whether defendant preserved its appeal of the trial court's refusal to allow the jury to decide whether plaintiff asserted its breach-of-warranty claim within the statute of limitations. Defendant raised the issue in a motion against the pleadings, motion for summary judgment, and motion for directed verdict, and the trial court denied all of those motions. During the discussion about jury instructions, the trial court informed the parties that it would not submit an instruction regarding statute of limitations to the jury because it interpreted its other rulings as deciding the issue as a matter of law. Defendant accepted the trial court's explanation without objection.

Defendant argued that it had sufficiently preserved the issue for appeal because trial counsel had asserted several times during trial that the statute of limitations issue was a question of fact reserved for the jury, which was all that was necessary for the trial court to identify its alleged error and correct it. But the court of appeals rejected the argument. Even assuming that defendant had sufficiently preserved the error, defendant failed to satisfy the procedural requirements of ORCP 61 B, which, if a jury is required to return a special verdict on each issue of fact, requires that a party object to the court's omission of any issue raised in the pleadings or evidence or forever waive the right to trial by jury on the issue.

C. ATTORNEY FEES / PREVAILING PARTY

A party who obtains a favorable judgment on appeal may not be the prevailing party for the purposes of an attorney-fee award if the appellate court determines that the favorable judgment does not result in a substantial modification to the judgment appealed.

Haynes v. Adair Homes, Inc., 231 Or App 144, 217 P3d 1113 (2009).

At trial, plaintiffs Paul and Renee Haynes and their children prevailed against defendant Adair Homes, Inc., for breach of a residential construction contract and negligence. Based on the attorney-fees clause in the construction contract, the trial court awarded attorney fees to the Hayneses and their children. Adair Homes successfully appealed the award of attorney fees to the children because they were not parties to the construction contract. *Haynes*, 227 Or App 536. Adair Homes obtained a favorable judgment on the appeal in that the appeals court remanded the case to the trial court to reconsider and reduce the award of attorney fees to the extent that the fees were solely attributable to the children's claims. Adair Homes then sought to recover its attorney fees as the prevailing party on appeal.

The Hayneses objected, asserting that Adair Homes should not have been designated the prevailing party on appeal, and the court of appeals agreed. Generally, under ORS 20.077(2), the prevailing party is "the party who receives a favorable judgment." Under ORS 20.077(3), however, the court of appeals has discretion to designate the prevailing party on appeal based on whether that party received a substantial modification of the judgment appealed. To be a substantial modification, the victory must be more than temporary or intermediate. Citing *Henderson v. Jantzen, Inc.*, 303 Or 477, 737 P2d 1244 (1987), which interpreted a predecessor statute to ORS 20.077, the court held that a temporary victory does not warrant the award of attorney fees because the party who temporarily prevails may ultimately lose the case on the merits.

Adair Homes' victory was temporary or intermediate because the Hayneses were still entitled to a substantial award on remand. There was no dispute that the Hayneses were the parties who received favorable judgment on both of their claims at trial, including an award of attorney fees under the construction contract. Although Adair Homes received a favorable judgment on appeal because the trial court was instructed to reconsider and reduce the attorney-fee award to the extent that it was attributable solely to the children's claims, the appellate judgment did not substantially modify the original trial judgment because the Hayneses were still entitled to recover a judgment on the merits and an award of attorney fees. Thus, the court of appeals exercised its discretion to designate the Hayneses as the prevailing party on appeal notwithstanding that Adair Homes received a favorable judgment.

D. CONSTRUCTION CONTRACTING: FLOW-DOWN PROVISIONS

A provision in a subcontract that incorporates the terms of the prime contract to the extent of the work to be performed by the subcontractor does not extend to general terms such as the attorney-fees clause.

Continental Cas. Ins. Co. v. Zurich Am. Ins. Co., No. 07-913-KI, 2009 WL 1884746, (D Or June 30, 2009).

General contractor TCR Pacific Northwest Construction 2002 Limited Partnership ("TCR") engaged Performance Contracting, Inc. ("PCI"), for framing and exterior stucco work for an apartment complex project under a subcontract that included, among other things, an attorney-fee clause entitling the prevailing party in a dispute to recover its attorney fees. The subcontract also required that PCI include in any sub-subcontract language binding the sub-subcontractor to all obligations and responsibilities that PCI assumed toward TCR "to the extent of the work to be performed by" each sub-subcontractor. PCI then entered into a sub-subcontract with Safway Services, Inc., in which Safway agreed to perform scaffolding work necessary to perform PCI's work. The Safway sub-subcontract included a "flow-down" clause in which Safway acknowledged that it had examined the terms of the PCI subcontract and agreed to assume PCI's obligations to TCR under PCI's subcontract. The Safway sub-subcontract also required Safway to carry insurance naming PCI and TCR as additional insureds.

During construction of the project, an employee fell and was severely injured. A dispute arose concerning defense costs. Among other things, the court held that Safway had breached its sub-subcontract by failing to obtain sufficient insurance. PCI and TCR sought to recover their attorney fees in the dispute over defense costs from Safway based in part on the attorney-fee clause in the PCI contract, which they argued bound Safway through the flow-down provision in the Safway sub-subcontract. Safway contended that the attorney-fee clause in the PCI contract applied only to disputes between PCI and TCR. Instead of incorporating all of PCI's obligations toward TCR under the PCI subcontract, the Safway subcontract incorporated only the terms related to Safway's performance of its work, namely, that Safway would perform the work in accordance with project plans and specifications included in the PCI subcontract.

The court agreed with Safway. The agreement between PCI and TCR to pay the prevailing party's attorney fees in the event of a dispute did not fall within the duties and obligations related to Safway's work of erecting the scaffolding, and thus was not a term to which Safway had agreed. The court commented that it would have been simple for PCI to include an attorney-fee clause in the terms and conditions of the Safway sub-subcontract if it wanted Safway to agree to it.

E. EVIDENCE/SUMMARY JUDGMENT

A party opposing a motion for summary judgment may not rely on "speculative probability" to create an issue of fact to avoid a motion for summary judgment.

Association of Unit Owners of Nestani—A Grecian Villa v. State Farm Fire and Casualty Company, 670 F Supp 2d 1156 (D Or 2009).

The plaintiff association owned a multi-building complex containing residential units originally constructed in 1982. By 1999, after discovering

instances of water intrusion, plaintiff engaged a repair contractor to investigate the cause and implement a remedy. The repair contractor identified long-term and dramatic water intrusion at walls, privacy fences, internal support posts, and other places. Within a couple of years, individual unit owners complained that the repair contractor did not repair the damage properly or address all of the existing dry rot, so plaintiff again retained the repair contractor to perform additional repairs. After those repairs, plaintiff purchased a policy from defendant State Farm Fire and Casualty Company, insuring against collapse during the policy period January 1, 2005, through January 1, 2007.

In or about November 2006, plaintiff alleged that it had discovered additional hidden decay that caused portions of the weight-bearing structural members of the buildings to collapse. State Farm adjusted losses for certain units and locations but denied coverage for the remaining damages. Plaintiff initiated this action to recover for all instances of collapse caused by hidden decay and alleged that State Farm breached the policy by wrongfully refusing to pay upon demand. State Farm moved for summary judgment on the breach-of-contract claim because plaintiff failed to prove that the loss commenced during the policy period and that the claim was asserted within the two-year limitation period established in the policy. State Farm also argued that the loss did not fit within the coverage for a sudden and entire collapse caused by hidden decay.

Because the relevant policy terms covered only "collapse" that "commenced" during the policy period, the court first looked at whether there was a genuine issue of fact that the collapse commenced during the policy period and whether plaintiff's claim was brought within the two-year limitation period in the policy. State Farm argued that the collapse commenced at the very first instance of collapse caused by hidden decay, which predated the policy period. Plaintiff responded that the collapse commenced each time portions of the structural members crumbled into pieces. Holding that the term "commenced" was ambiguous under the policy, it construed the meaning against State Farm.

But the court also concluded that plaintiff failed to create an issue of fact that a collapse occurred during the policy period because its evidence was only expert speculation about when collapse or crumbling occurred. At deposition, plaintiff's expert witnesses speculated that dry rot crumbled in each of the policy years and the years leading up to it. But they also admitted that they could do no more than to provide a "guestimate" that crumbling occurred during the policy period. The two-year policy period was so short that neither expert could testify with certainty that the crumbling occurred during the policy period. Similarly, State Farm's expert testified that portions of some of the structural members "probably" fell into pieces during the policy period. The court held that the experts' speculative deposition testimony did not create an issue of fact for summary judgment. Because plaintiff did not create an issue of fact concerning whether any collapse occurred during the policy period, it similarly could not create an issue of fact that it brought its claim within two years from the time a collapse commenced.

The court also evaluated whether plaintiff's loss was a "collapse" covered by the policy language. The policy defined "collapse" to involve the "sudden, entire collapse of a building or any part of a building." Deriving the parties' intent from the policy language, the court accepted plaintiff's argument that a collapse did not require the entire building to fall into pieces, but also covered a situation when any part of the building sustained substantial impairment to its structural integrity. But the court rejected plaintiff's contention that its loss was sufficiently "sudden" to be covered by the policy. The term "sudden" was not defined in the policy, so the court looked to its plain dictionary meaning and found that it meant that it had a temporal element—meaning it happened abruptly or in a very short time. The undisputed facts in this case, however, showed that plaintiff's loss occurred from water damage and decay occurring over decades. Thus, the collapse was not sudden. Finally, the court also rejected plaintiff's contention that the

deterioration of portions of individual structural members fell within the policy requirement of an "entire collapse of a building or any part of a building." The policy language distinguished a "part of a building" in the context of the policy to be something essential to the completeness of the building, whereas a "portion" was merely something lesser and not essential. In other words, until the crumbling of a portion of a structural member caused the entire structural member to collapse, the crumbling did not qualify for coverage under the policy.

F. GARNISHMENT

A contractor's insurance policy proceeds are subject to garnishment only if the contractor's liability is covered under the insurance policy.

Shilo Inn, Seaside Ocean Front v. Grant, No. 08-CV-618-BR, 2009 WL 2611217 (D Or Aug. 24, 2009).

Shilo Inn, Seaside Ocean Front, LLC, engaged James Grant dba Touchstone Granite & Marble ("Grant") to install granite surfaces at its hotel. During the course of the work, Shilo Inn complained that most of the work would need to be redone because of poor workmanship. Grant eventually ceased work, and Shilo Inn engaged a replacement contractor to correct and finish the work. Shilo Inn then initiated an arbitration against Grant and was awarded a judgment in the amount of $373,795 plus attorney fees in the amount of $140,000. After the arbitration award was recorded as a judgment, Shilo Inn filed a writ of garnishment noticing Grant's insurer, Maryland Casualty Company, as garnishee.

A writ-of-garnishment proceeding ensued. Shilo Inn argued that its damages were covered by Grant's commercial general liability policy because Shilo Inn had suffered property damage caused by water intrusion. Maryland Casualty countered that the damages were not covered under the policy because of a "your work" exclusion. Deferring to the arbitrator's factual findings, the court evaluated each component of damage constituting the arbitration award to determine whether the exclusion applied. The court found that each component constituting the principal damages of the award was related to restoring, repairing, and replacing Grant's work. Conversely, the arbitrator found that there was little evidence of water intrusion behind the granite and did not assign any monetary damages for property damage caused by water intrusion. Because the moneys awarded in the arbitration were excluded by the "your work" exclusion in the policy, the court agreed with Maryland Casualty and granted summary judgment in its favor.

G. INSURANCE LAW: RIGHT TO EQUITABLE SETOFF

An insurer may be entitled to equitable setoff if its insured recovers from third parties for the same damages, but the settlement may not include the cost the insured incurred to settle with the third parties or the value of the "litigation risk" represented in the settlement.

Malbco Holdings LLC v. AMCO Insurance Company, 2010 US Dist Lexis 2007, No. CV-08-585-ST (D Or Jan 11 2010).

Plaintiff Malbco Holdings LLC purchased a recently constructed hotel in Eugene, Oregon, after which it discovered water damage that eventually lead to a collapse of parts of the hotel. Malbco initiated an arbitration against the original contractor and its subcontractors, and it submitted a claim against its insurer. Malbco claimed a total loss of more than $2.2 million, which comprised the repair costs, lost room-rental profits, and interest on the lost room profits.

After mediation, Malbco settled with the contractor and subcontractors for $1.65 million. Malbco's insurer, however, denied coverage. Because the settlement with the contractors did not fully compensate Malbco, Malbco initiated an action against the insurer for wrongful denial of coverage under the policy. The jury awarded Malbco $941,268 for the repair costs and lost profits caused by the collapse. The insurer argued that the jury's award should be offset by the $1.65 million that was received from the contractors, which Malbco contested.

The court recognized that, generally, Oregon law permits a non-settling defendant to receive a credit

in the amount of prior settlements when the plaintiff has settled with others for the same damages. This right, called equitable setoff, inures to insurers. Equitable setoff prevents a plaintiff from recouping more than its total losses. In this case, were Malbco to keep both the settlement fund and the jury award, it would recover at least $300,000 more than its total losses. Equitable setoff, however, is not appropriate in every case.

Here, Malbco asserted that AMCO was barred from setoff for several reasons, but the court rejected each one. Malbco argued that the insurer should not be able to benefit in equity because it breached its contract by denying coverage. Similarly, it contended that the insurer had unclean hands preventing it from relying on equity. But by simply denying coverage, the insurer did not forfeit a right to offset or act with unclean hands; otherwise, an insurer would never receive the benefit of offset.

Malbco also argued that the insurer should not receive a setoff because its denial caused Malbco to engage in costly, time-consuming, and risky litigation against the contractor and its subcontractors. Any unfairness to Malbco created by the litigation with the contractor and subcontractors, however, could be remedied by deducting from the offset Malbco's fees and expenses incurred to reach the settlement.

Finally, Malbco argued that the collateral-source rule allowed it to recover damages under the settlement and the policy, even if the total recovery were duplicative. The court, however, rejected Malbco's position as applying the rule backwards. The collateral-source rule is limited to tort claims and acts to prevent a tortfeasor from benefiting from the injured party's right to recover from others. In this case, the contractor and its subcontractors were the tortfeasor, not the insurer. Furthermore, the insurer was not seeking an offset for any insurance benefits that Malbco received from others, but instead from the contractor's settlement payments.

Having ruled that the insurer was entitled to equitable setoff, the court turned to the amount of setoff. Malbco contended that the jury award should first be reduced by the amount of lost room-rental profits not included in the settlement and then reduced further by its costs to settle the claim with the general contractor, plus the litigation risk, leaving a maximum offset of no greater than approximately $200,000. The insurer contended that the offset should be the full amount of the settlement proceeds, leaving no net judgment or, alternatively, that the offset be reduced by only the arbitration costs.

The court rejected Malbco's contention that the amount subject to setoff should be reduced by the lost room-rental profits because it found that the settlement included them. Although Malbco was bound by a waiver of lost profits provision in the contract with the contractor, Malbco, as a subsequent owner of the property, had pursued a negligence theory against the contractor, too. It had the right to recover the lost room-rental profits under that claim.

The court accepted Malbco's contention that the insurer was not entitled to a setoff against Malbco's arbitration costs incurred in reaching the settlement with the contractors. Additionally, the court accepted Malbco's contention that the insurer was not entitled to a setoff against the amount of Malbco's litigation risk. The insurer had argued that the settlement was an arms-length agreement that Malbco was free to reject if it did not sufficiently compensate it for its damages, and thus the litigation risk was of Malbco's own creation. But the court recognized that there are several risks in any dispute that necessarily push settlements to amounts less than those fully claimed or incurred. The risks are the same whether incurred by Malbco or by the insurer after accepting the claim and pursuing its subrogation rights. The court determined that the amount of the jury award not subject to equitable offset because of litigation costs equaled Malbco's total losses, less betterment and other amounts it was not entitled to recover, less the settlement amount. In the end, the jury award was reduced to an amount equal to the litigation risk and arbitration costs.

H. NEGLIGENCE

An owner who designs and builds his or her own home or improvements may be liable to subsequent owners under general principles of negligence.

Cowan v. Nordyke, 232 Or App 384, 222 P3d 1093 (2009).

Defendant Nordyke designed and built his own home, but later sold it to the Cowans. The Cowans discovered substantial water damage to the framing, floors, and walls that they attributed to Nordyke's negligent design of the home and sought to hold Nordyke liable for professional negligence. Nordyke obtained summary judgment against the Cowans' claims because Oregon law does not recognize the tort of professional negligence by a homeowner who acts as his own designer. Thus, the Cowans sought to amend the complaint to add claims for negligent design and construction under general negligence principles. The trial court denied the motion to amend, holding that the Cowans had failed to state a claim for negligence.

On appeal, the court of appeals affirmed the trial court's summary judgment on the professional negligence claim, but reversed the trial court's ruling that the Cowans had failed to state a claim for negligence. Nordyke conceded that the Cowans' complaint stated a claim for negligence if the court applied the general foreseeability principles identified in *Fazzolari v. Portland School Dist. No. 1J*, 303 Or 1, 734 P2d 1326 (1987), and its progeny. But Nordyke argued that the court should not apply general foreseeability principles because his relationship to the Cowans as either an unlicensed builder-contractor or an "owner-builder" limited his duty to the Cowans. Nordyke asserted that his only duty was to disclose the fact that he had built the house himself and to disclose known defects.

Nordyke first asserted that he could not be liable for negligent construction of the house because he did not have a contractor's license and thus could not be held to the standard of care of a builder. In particular, Nordyke argued that a jury would not be able to determine what constituted reasonable care of an unlicensed builder in building his own house. Nordyke further contended that holding unlicensed builders to a general standard of care for builders would open the door to a new category of claims against the average homeowner (also typically unlicensed) who self-perform repair or remodeling projects.

The court of appeals disagreed. Juries are frequently called on to determine what constitutes negligent conduct in areas outside their personal realm of experience, and thus the court saw no reason why a jury could not determine whether an unlicensed builder had exercised reasonable care in building a house and whether any resulting damages were foreseeable. Additionally, the risk that the average homeowner could be exposed to increased litigation was not a sufficient reason to deny Nordyke's liability for negligence.

Nordyke next argued that as an "owner-builder," he owed no duty to the Cowans except to disclose known defects as required in statutory property disclosure statements. Nordyke further asserted that the buyer has sufficient remedies for fraud or breach of contract if the seller failed to disclose or misrepresented the defects. The court of appeals rejected Nordyke's arguments, holding that the disclosure of known defects is insufficient to protect a homebuyer from the owner-builder's negligence. Because Nordyke's relationship to the Cowans did not limit Nordyke's duty under general foreseeability principles, the Cowans stated a claim for negligence.

I. PREVAILING WAGE LAW: PUBLIC/PRIVATE JOINT VENTURES

A privately financed construction project built in conjunction with a public works project is not subject to the prevailing wage requirements even when the projects share common features and allow for cross use of the project facilities.

State v. City of Salem, 231 Or App 127, 219 P3d 32 (2009).

In 2000, VIP's Motor Ends, Inc., purchased a vacant lot in downtown Salem. It then approached the Urban Renewal Agency of the City of Salem ("the "Agency") about the possibility of a public/private development of a conference center and hotel on the

property. As a result, the Agency purchased one-half of the property, and VIP sold the remaining half to the Salem Group LLC (the "Salem Group"), an LLC created by VIP to develop the hotel property.

The Salem Group and the Agency entered into a number of agreements concerning the joint undertaking. The Agency was responsible to construct and own a conference center and parking garage, and the Salem Group would construct and own the hotel. Both parties used the same developer and general contractor but contracted separately for the work. To take advantage of efficiencies from joint development, certain components of the projects were designed to share commonalities, including a parking garage, common walls, and a kitchen and restaurant area located in the hotel. The parties entered into lease agreements to set forth the terms of joint use of the parking garage, kitchen, and restaurant.

The Agency's conference center was funded in part by a loan guaranteed by the United States Department of Housing and Urban Development ("HUD"). As part of the application for the funding, HUD issued a determination that the federal Davis-Bacon Act required the payment of prevailing wages on the construction of the conference center and parking garage only, but did not require it for the construction of the hotel and leasehold improvements. The Agency, however, elected to pay prevailing wages on the leasehold improvements and other joint improvements because they were financed in part by public funds. Only the workers on the hotel construction were not paid federal or state prevailing wages.

The Bureau of Labor and Industries ("BOLI") received a complaint by one of the hotel construction workers and asserted that prevailing wages were owed on the construction of the hotel. Agreeing to the material facts, the parties submitted the controversy on summary judgment to the circuit court on the question of whether the hotel was a "public work" for the purpose of the prevailing wage law.

The trial court held that the construction of the hotel was not "carried on" or "contracted for" by a public agency, and thus was not a public work under Oregon law. It also found that the primary purpose of the hotel was not to serve the public interest and that no funds of a public agency were used directly or indirectly in the construction of the hotel. Thus, it granted the Agency's motion and entered a judgment against BOLI. The trial court also allowed the Agency's petition for attorney fees under ORS 182.090 because BOLI had no reasonable basis in law or fact to bring the action, finding that the suit was in contravention of established case law and its own administrative rules. BOLI appealed both the underlying judgment and the judgment for fees.

The court of appeals upheld the underlying judgment, but reversed the award of fees. The court rejected BOLI's argument that the two buildings were actually one for the purpose of the prevailing wage law. The "mere fact that two separately owned buildings, which were designed to complement one another and eliminate redundancies, happened to share certain components, does not automatically convert them into a single building or public work under the common meaning of those terms." In particular, no reasonable trier of fact could find that two independently owned and financed buildings comprise a single building for the purposes of the prevailing wage law.

Additionally, the court rejected BOLI's argument that the Agency had "contracted for" (as the term was used in the prevailing wage statutes) the construction of the hotel by entering into a development agreement with the Salem Group that required the Salem Group to build the hotel. The "contracted for" language in the prevailing wage statutes was not intended to encompass situations where the public agency is not a party to the construction contract, does not own the property at the time the work is undertaken, and makes no subsequent use of the property, as was the case with the hotel. *Portland Development Comm. v. BOLI*, 216 Or App 72, 171 P3d 1012 (2007). The fact that the Agency leased certain portions of the hotel was not enough to change that fact.

The court of appeals, however, reversed the award of attorney fees. BOLI's theory in bringing the claim, although incorrect, was not devoid of factual

and legal support. BOLI asserted its claim before the decision in *Portland Development*. Until that case was decided, the meaning of the term "contracted for" in the statute had not been adjudicated in a published appellate opinion, and thus BOLI's interpretation had at least been plausible. Furthermore, notwithstanding *Portland Development*, certain facts in the Agency project were different from *Portland Development*, such that the question of whether the Agency "contracted for" the hotel was a closer case. Therefore, BOLI's position was not without reasonable factual or legal basis, and the Salem Group was not entitled to attorney fees.

THE OREGON FALSE CLAIMS ACT AND ITS IMPACT ON PUBLIC WORKS PAYMENT CLAIMS

Jesse Ormond
Stewart Sokol & Gray LLC

The Oregon False Claims Act, ORS 180.750 - 180.785 ("OFCA"), is a newly enacted body of law that allows the Oregon State Attorney General to aggressively prosecute suspected false or fraudulent claimants related to public works contracts. The OFCA's purpose is simple: eliminate and deter inflated claims for payment. To this end, Oregon joins its sister states in adopting a false claims act patterned after federal statutes. Importantly, Oregon's version dramatically impacts contractors and subcontractors on public works projects because related claims for payment are now subject to critical review and potential civil liability.

I. The Oregon False Claims Act : Mechanics

The OFCA provides the Oregon State Attorney General a civil cause of action against persons presenting "false claims" to public agencies. ORS 180.760. Specifically, the Attorney General may file a claim against persons for (1) presenting false claims for payment or approval, (2) knowingly making or using records or statements based on false or fraudulent information, (3) conspiring with others to present known false claims, (4) delivering property to a public agency in an amount the person knows is less than the amount for which the person receives a certificate or receipt, (5) making or delivering a document certifying receipt of property based on known false or fraudulent information, (6) purchasing public property from a public officer or employee known to be unauthorized to sell the property, (7) receiving property from a public officer or employee known to be unauthorized to pledge the property, and (8) making or using a known false or fraudulent statement to conceal, avoid or decrease an obligation to pay or transmit money or property to a public agency. ORS 180.755. Needless to say, this list is extensive.

The Act has teeth. For each violation, the OFCA imposes a punitive damages award of either $10,000.00 or an amount equal to **twice** the damages incurred by the public body, **whichever amount is greater**. ORS 180.760(4). Moreover, a court may hold both the individual and his/her legal entity liable for violations under the OFCA, imposing separate penalties on each. Id. at (5). This means that a person submitting a false claim for payment may be held responsible in his/her *individual* capacity alongside his/her business.

In addition to punitive damages, the OFCA provides the State other forms of recovery. First, the State is entitled to its actual damages resulting from the claimant's submission of a false claim. ORS 180.755(4). This primarily concerns the State's recovery of undue payments made to the claimant, but might also include damages for processing or reviewing the claim. Second, the State has a right to its reasonable attorneys fees where the State prevails in the action. ORS 180.760(8). By way of comparison, a prevailing claimant only has a right to attorneys fees where the court holds that the Attorney General had no "objectively reasonable basis" for filing the action. Id. Thus, the State has incentive to file claims against suspected false claimants without penalty for being wrong. Moreover, the OFCA does not

limit any other civil or criminal penalties available to the State. ORS 180.785.

The OFCA, then, provides the Attorney General a vehicle to severely punish persons submitting false or fraudulent claims. The State's recourse might be substantial, as a complaint can allege multiple claims for the same submission. For example, the Attorney General might seek $10,000.00 in punitive damages for presenting a claim that is knowingly false and an additional $10,000.00 for conspiring with others regarding the same claim. This, coupled with compensatory damages, attorney fees and liability imposed on both the individual and business entity provides the State a powerful tool to eliminate and deter false or fraudulent claims.

The OFCA does, however, provide claimants an opportunity to avoid civil penalties concerning the filing of a false or fraudulent claim. ORS 180.760(6). To receive this protection, the claimant must, ***before*** the Attorney General commences a court proceeding or administrative action, (1) fully cooperate with the Attorney General in the investigation of an alleged violation and, (2) provide the Attorney General with all known information concerning the violation within thirty (30) days of acquiring the information. Id. Importantly, this protection is subject to discretion and only concerns the punitive damages award. See Id. A false or fraudulent claimant always faces liability for actual damages incurred by the government.

II. Distinguishing the OFCA From the Federal False Claims Act

The OFCA is patterned after the Federal False Claims Act, 31 USC 3729, *et seq.* ("FFCA"). With this legislation, Oregon joins more than thirty states in enacting similar laws to eliminate and deter false or fraudulent claims. The OFCA and FFCA are quite similar. Nonetheless, the two acts maintain a few critical distinctions.

For example, the FFCA, unlike the OFCA, contains an express *qui tam* provision that provides private persons a cause of action against false or fraudulent claimants. 31 USC 3730(b). The *qui tam* provision exists to encourage collaboration with the government to discover and prosecute false or fraudulent claimants. The act facilitates collaboration by awarding a percentage of the proceeds or settlement to the private person. 31 USC 3730(d). Importantly, the FFCA offers a healthy award to private persons, ranging from fifteen percent (15%) to thirty percent (30%), contingent on a number of factors, including the extent of the private person's contribution to the prosecution of the action or information disclosed to the government. Id. This incentive encourages persons familiar with a project to closely examine and report suspicious claims for payment. However, Oregon does not employ this incentive and only allows the Attorney General to file civil claims under the OFCA.

A second distinction between the FFCA and the OFCA concerns the Armed Forces. The FFCA expressly bars a person from knowingly presenting a false claim to members of the Armed Forces of the United States. 31 USC 3729(a)(1). This provision exists because the United States Army, Navy, Marine Corp., Air Force and Coast Guard offer extensive public works contracts. There is no need for the OFCA to include these Services because Oregon does not maintain unified military forces. Nonetheless, the OFCA potentially and implicitly references the United States Armed Forces under its definition of a "public agency," which includes the United States and federal agencies. ORS 18.750(3). In any event, a false or fraudulent claimant on a public works project let by the United States Armed Forces likely only faces liability under the FFCA and not the OFCA.

Another important distinction between the FFCA and OFCA concerns the damages award. Oregon, as noted above, imposes a substantial punitive damages award on offenders of the OFCA. ORS 180.760(4). Specifically, an offender faces a penalty of $10,000.00 or twice the amount of damages incurred by the public body, whichever amount is greater. Id. The FFCA penalty, however, is even higher. A person in violation of the FFCA receives a minimum civil

penalty of $5,000.00, maximum civil penalty of $10,000.00 ***and*** three times the amount of damages incurred by the United States. 31 USC 3729(a). This could result in a substantial amount more than an offense under the OFCA. To this end, the OFCA allows a mitigation of civil penalties where the claimant's violation of the OFCA is also the basis for a judgment under the FFCA. See ORS 180.760(4). A similar mitigation allowance exists where the offender is found liable under the federal Civil Monetary Penalty Law, 42 USC 1320a-7a. Id. Note, however, that the OFCA ***allows*** and does not ***require*** a punitive damages mitigation. A false or fraudulent claimant could face severe punitive damages under both acts.

The distinctions between the FFCA and OFCA are relevant to determine a claimant's potential liability and the particular damages he/she faces. While the statutes are similar, it is important to appreciate these distinctions when performing on an Oregon public works project. The basic tenet, however, remains the same: persons submitting false or fraudulent claims for payment on a public works project face significant civil liability.

III. Impact on Contractors and Subcontractors Performing Improvements on Public Works Projects

Contractors and subcontractors face potential litigation and substantial damages on submitting a questionable claim for payment to a public body. The OFCA's desired effect is to eliminate and deter false or fraudulent claims, but also to force claimants to carefully evaluate their submissions prior to requesting payment. To this end, contractors and subcontractors must evaluate their process for quantifying claims prior to submission, including the preservation of supporting documents and evidence.

Importantly, the OFCA is a complex and new body of law with a context specific application. A contractor or subcontractor facing prosecution under the OFCA should immediately contact an attorney familiar with these actions. Similarly, a contractor or subcontractor would be wise to consult with an attorney ***prior to*** submitting a claim that might be subject to some question or speculation. In short, the OFCA presents a new concern for contractors and subcontractors performing on public works projects in Oregon. These entities should take note.

CONSTRUCTION CONTRACTORS BOARD PROPOSED 20111 LEGISLATION

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Construction Contractors Board

The CCB is presenting only three modest housekeeping proposals to the upcoming legislature.

LC 625 – Clarification of the definition of a Home Inspector

Historically, home inspectors provided the service of reviewing all home components, usually before a sale of the property. The individual performing this work must be certified by the Construction Contractors Board (CCB) as a home inspector and must work for a CCB-licensed contractor. Recently, businesses have begun offering services involving only limited inspection of homes - as part of an energy audit or a forensic building inspection for instance.

A "home inspector" is defined as "a person who, for a fee, inspects and provides written reports on the overall physical condition of a residential structure." It is unclear whether companies providing limited inspections fit in this definition.

LC 625 amends ORS 701.350(2) to allow CCB to adopt rules determining whether an inspection and report that is limited to one or more specific systems or components in a house is a sufficient assessment of the overall physical condition to constitute the services of a home

inspector. CCB will be able by rulemaking to determine whether companies such as those providing energy audits or forensic building inspections should be required to employ a certified home inspector.

LC 626 – Arbitration of a Dispute Resolution Services complaint

Contested case hearings lengthen the time it takes to resolve a Dispute Resolution Service (DRS) complaint. For fiscal year 2008 – 2009, it took on average 193 days to close a DRS complaint. CCB is concerned that it takes too long to resolve these complaints.

Under current law, the CCB may require that a complaint of less than $1,000 to be decided by binding arbitration. For complaints involving a higher damage allegation either party may request a contested case hearing. A contested case hearing, with a possible appeal to CCB's Appeal Committee, takes longer than binding arbitration.

LC 626 would increase the threshold for mandatory binding arbitration from $1,000 to $5,000.

LC 627 Clarify the definitions of residential and commercial structures

The definitions of residential and commercial structures cover the main structures but they do not mention appurtenant structures built on the same property. Clarity in these definitions is important because individuals and businesses use them to determine what license endorsement to obtain and the procedure to file DRS complaints. The CCB uses the definitions to determine whether to assess a sanction for violating the law. Not having a definition that includes minor structures causes confusion for contractors, consumers and CCB.

LC 627 adds the term "appurtenance" to the definitions of "residential structure" and "small commercial structure". (The definition of large commercial structure is a catch-all definition that includes any structure not defined as a residential or small commercial structure.)

SPOLIATION SANCTIONS 101

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"Spoliation of evidence," is the "destruction or significant alteration of evidence, or the failure to preserve property for another's use as evidence, in pending or future litigation." *Hernandez v. Garcetti,* 68 Cal.App.4th 675, 680, 80 Cal.Rptr.2d 443 (1998). Obviously, the failure to preserve evidence can be troublesome in any dispute and construction cases are no exception.

While attorneys recognize the need to preserve evidence if a matter is brought to their attention in a timely fashion, clients sometimes forget, or fail to recognize the need for preservation, particularly if they don't view the evidence as meaningful. The question is what consequences are in store for a party that forgets to preserve evidence, or, worse yet, deliberately destroys it?

Oregon state law provides little guidance on this issue. True, there are available sanctions for failure to comply with discovery. *See, e.g.,* ORCP 46. However, one cannot produce evidence that no longer exists and it would seem that the rule has little application if evidence is spoliated before discovery obligations arise. Indeed, the evidence may have been lost, discarded or destroyed before the lawyer was even contacted.

In addition to sanctions under ORCP 46, two provisions of the Oregon Evidence Code appear relevant to this discussion. First, OEC 311(1)(c) establishes a "permissive" presumption that: "Evidence willfully suppressed would be adverse to the party suppressing it." In a civil case "a presumption imposes on the party against whom it is directed the burden of proving that the

nonexistence of the presumed fact is more probable than its existence." OEC 308.

No Oregon case has interpreted the term "willfully suppressed" in OEC 311(1)(c). The term appears on its face to exclude negligent destruction. It is unclear, however, whether the presumption is triggered by "intentional" destruction or whether it requires an additional showing of bad faith or an improper motive.

In *Stephens v. Bohlman*, 138 Or App 381, 909 P2d 208 (1996) the presumption arose in the context of a medical malpractice lawsuit. The issue before the court was whether facts showing that a physician had concealed evidence was admissible to prove he was negligent.

Defendant argued the evidence was relevant only to Plaintiff's allegation that she did not know she had a tort claim and not to the issue of negligence. The court disagreed, citing OEC 311(1)(c), and stated that the concealment was "circumstantial evidence of his belief that he [the physician] had acted negligently" and was admissible against Defendant to prove negligence. The court stated that "evidence that an alleged tortfeasor attempted to conceal the true cause of the injury at least permits a jury to draw an unfavorable inference." Although *Stephens* involved a case that arguably demonstrated bad faith motivation, the court did not purport to apply OEC 311(1)(c) or state that the presumption was inapplicable if only an "intentional" act was proven.

Second, Oregon courts have broad authority regarding the admissibility of evidence pursuant to OEC 403 [Exclusion of relevant evidence on grounds of prejudice, confusion or undue delay.] nevertheless, The application of this rule when evidence has been destroyed is not entirely clear.

The analytical process by which the court applies OEC 403 was stated in *State v. Burgess*, 145 Or 334, 930 P2d 869 (1996):

> Under OEC 403 there is a two-step process. We must first inquire whether the admission of the evidence creates a danger of unfair prejudice. Second, even if the danger of unfair prejudice exists, the evidence is still admissible unless that danger substantially outweighs the evidence's probative value. [Citation omitted.]

That case also explained the meaning of the term "unfair prejudice" in the first step of this process:

> In *State v. O'Key*, 321 Or 285, 321, 899 P2d 663 (1995), the court said, regarding OEC 403: "'[U]nfair prejudice does not mean 'evidence [that]is harmful to the opponent's case – a central reason for offering evidence.' * * * '<u>Unfair prejudice' describes a situation in which the preferences of the trier of fact are affected by reasons essentially unrelated to the persuasive power of the evidence to establish the fact of consequence</u>." (Emphasis added.)

Similarly, the court in *State v. Sparks*, 336 Or 298, 308, 83 P3d 304, *cert den* 543 US 893 (2004) stated:

> In the context of OEC 403, 'unfair prejudice' means 'an undue tendency to suggest decision on an improper basis, commonly although not always an emotional one.' *State v. Moore*, 324 Or 396, 407-08, 927 P2d 1073 (1996)

No Oregon cases appear to exist that hold that spoliated evidence consisutes "unfair prejudice." Moreover, exclusion of probative, admissible and relevant evidence is permissible under OEC 403 only if a jury would make a decision on an "improper basis;" that is, "unrelated to the persuasive power of the evidence." *State v. Burgess, supra.* In summary, the reasons for exclusion of evidence pursuant to OEC 403 are different than the reasons for the imposition of sanctions as a result of spoliation.

Although ORCP 46, OEC 311 and OEC 408 may be available in the appropriate case, Oregon law has not directly addressed sanctions for spoliation. In such a situation, it is natural to turn to federal court cases for guidance. Federal courts,

however, are not always in agreement as to when spoliation sanctions are appropriate.

First, federal courts are split regarding whether state or federal law governs the imposition of sanctions in diversity cases. *Pirv. v. Glock*, 2009 WL 54466, p. 4 n. 2 (D.Or. 2009). The Ninth Circuit applies federal law. *Id.* Therefore, even if Oregon adopts a standard for spoliation sanctions, that standard probably is applicable in the Ninth Circuit.

Second, sanctions for spoliation, including dismissal of an action are permissible under the federal court's inherent power to control litigation. *US v. $40,955 in U.S. Currency*, 554 F3d 752, 757 (9th Cir. 2009).[1] One may presume the Oregon courts will adopt a similar basis for action.

Third, federal courts are split about the requisite *mens rea* necessary to support the imposition of sanctions. *See, e.g., United Medical Supply Company, Inc. v. United States,* 77 Fed. Cl. 257, 266 (Ct. Cl. 2007) (discussing split among circuits). In other words, what culpable mental state triggers the most severe sanctions?

This question is particularly important since the party seeking sanctions has the burden to establish that the evidence was destroyed or lost after the duty to preserve it arose. *See U.S. v. Maxxam, Inc.,* 2009 WL 817264 (N.D. Cal. 2009)(holding that while Court was troubled that no instructions were give to the custodian of the records to retain them, there was insufficient evidence that the records were still in existence by the time a duty to preserve evidence arose.)

A minority of circuits require a showing of bad faith before any form of sanction is applied. *United Medical Supply, supra, citing S.C. Johnson & Son, Inc. v. Louisville & Nashville R. Co.* 695 F.2d 253, 258-59 (3rd Cir. 1982); *Vick v. Texas Employment Commission,* 514 F.2d 734, 737 (5th Cir. 1975); *Coates v. Johnson & Johnson,* 756 F.2d 524, 551 (7th Cir. 1985).

Other circuits require a showing of bad faith only for the imposition of most serious sanctions, such as the application of an adverse inference or the entry of a default judgment. *United Medical Supply Company, supra* at 266 - 267, *citing 103 Investors I, L.P. v. Square D Co.,* 470 F.3d 985, 988-89 (10th Cir.2006); *Harlan v. Lewis,* 982 F.2d 1255, 1260 (8th Cir. 1993), *cert. denied, Hall v. Harlan,* 510 U.S. 828, 114 S.Ct. 94, 126 L.Ed.2d 61 (1993); *Berkovich v. Hicks,* 922 F.2d 1018, 1024 (2d Cir.1991); *Allstate Ins. Co. v. Sunbeam Corp.,* 53 F.3d 804, 806-07 (7th Cir.1995).

Even if bad faith is not required to impose sanctions, courts may still require proof of purposeful, willful or intentional conduct. *See, Nye v. CSX Transp., Inc.,* 437 F.3d 556, 569 (6th Cir.2006) (willful destruction required to demonstrate spoliation of evidence); *Trentadue v. United States,* 386 F.3d 1322, 1343 (10th Cir.2004), *modified on rehearing, sub nom., Estate of Trentadue ex rel. Aguilar v. United States,* 397 F.3d 840 (10th Cir.2005) ("Mere negligence in losing or destroying records is not enough because it does not support an inference of consciousness of a weak case."); *Hodge v. Wal-Mart Stores, Inc.,* 360 F.3d 446, 450 (4th Cir.2004) (inference cannot be drawn merely from negligent loss or destruction of evidence, but requires a showing that willful conduct resulted in the loss or destruction); *Gumbs v. Int'l Harvester, Inc.,* 718 F.2d 88, 96 (3d Cir.1983) (adverse inference from the destruction of evidence arises only where destruction was intentional).

The Ninth Circuit will not impose a sanction of dismissal unless the conduct is due to "willfulness, fault or bad faith." *Pirv v. Glock, supra.* A lesser sanction is available only if the party "willfully destroyed" the evidence. *Id.*[2]

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[1] Spoliation sanctions are reviewed on appeal under an abuse of discretion standard. *Leon v. IDX Systems Corp.,* 464 F3d 951 (9th Cir. 2006).

"Willful" destruction, however, can arise "when a party had some notice that the evidence was potentially relevant" to litigation. *Id.* (Emphasis added.) Notice that evidence is potentially relevant can arise before litigation is filed.

In *Washington Alder LLC v. Weyerhaeuser Co.*, 2004 WL 4076674 (D. Or. 2004) Judge Panner stated:

> The duty to preserve relevant evidence commences prior to the filing of the action, once the defendant reasonably anticipates an action may be forthcoming. *See Silvestri v. General Motors,* 271 F.3d 583, 590 (4th Cir.2001); *Kronish v. United States,* 150 F.3d 112, 126 (2d Cir.1998). *See also Akiona v. United States,* 938 F.2d 158, 161 (9th Cir.1991) (defining inquiry as whether party that destroyed documents "was on notice that the [documents] had potential relevance to litigation"); *United States v. Kitsap Physicians Service,* 314 F.3d 995, 1001 (9th Cir.2002) (discussing when defendant has a duty to preserve records prior to commencement of litigation). *Id.*, at 1.

In contrast, the destruction of records pursuant to a document retention policy may not trigger sanctions. In *Akiona v. United States,* 938 F.2d 158, 161 (9th Cir. 1991) the Ninth Circuit reversed spoliation sanctions imposed by the district court, which had shifted the burden of proof to the government based on the government's destruction of records.

The Ninth Circuit agreed that "a trier of fact may draw an adverse inference form the destruction of evidence relevant to a case." *Id.*, 161. However, the court found the imposition of any sanctions inappropriate when the evidence was destroyed pursuant to a retention/destruction policy, because the underlying rationales for sanctions are not applicable in that circumstance. The court stated:

> Indeed, the government may have destroyed the records pursuant to its policy of destroying documents regarding grenades two years after their disposition. Unlike *Welsh*, 844 F.2d 1239, in which the destruction of medical evidence clearly violated a hospital policy, the destruction of the records in this case could have been entirely consistence with the government's document retention policies. . . Because the government's destruction of records is neither relevant nor indicative of bad faith, the district court erred in shifting the burden of proof to the government. [3] *Id., 161.*

The court summarized by saying that: "A party should only be penalized for destroying documents if it was wrong to do so, and that requires, at a minimum, some notice that the documents are potentially relevant." *Id.* (Emphasis added.)

In summary, Oregon law is unclear on the imposition of sanctions for spoliation. Assuming Oregon courts agree that they have authority to impose such sanctions, and assuming Oregon follows the majority rule in the federal courts, proof of bad faith is not required. Nonetheless, the party seeking sanctions will need to demonstrate "willfulness" on the part of the part against whom sanctions are sought. Willfulness can be established by a showing that the evidence was destroyed or failed to be preserved at a time when the evidence was potentially relevant. Notice that

[2] The court's statement that proof of "willfulness" is necessary to justify dismissal while proof of "willfulness" to justify a lesser sanction is confusing. As this author reads the cases, proof of "willfulness" to support the sanction of dismissal probably requires a showing of bad faith. In contrast, while proof of bad faith is probably unnecessary if a lesser sanction is sought.

[3] The court's reference here to "bad faith" is confusing. If "bad faith" is not required to support a sanction less than a dismissal than showing a lack of bad faith is irrelevant. The court's further statement that the documents must have been "potentially relevant" at the time of their destruction adheres more closely to the Ninth Circuit's legal standard.

evidence is potentially relevant to litigation can occur before litigation is filed. This standard should encourage attorneys to contact their clients at the earliest possible time to ensure that potentially evidence is preserved. Otherwise, parties take the risk that some level of sanctions will be imposed.

BID PROTESTS: THE PRIORITY BETWEEN THE HUBZONE AND 8(A) SBA PROGRAMS

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Two recent cases before the Court of Federal Claims looked at the relative priorities of the HUBZone and 8(a) programs, both of which are promulgated by the Small Business Administration (SBA). The 8(a) program benefits economically disadvantaged businesses. Under the program, when certain criteria are met, a contract is awarded on the basis of competition limited to 8(a) businesses. The historically underutilized business zone (HUBZone) program targets businesses located within certain designated zones. The HUBZone program includes sole-source contracts, contracts awarded on the basis of competition limited to HUBZone businesses, and bid adjustments if the contract is awarded in an open competition.

In *Mission Critical Solutions v. United States,* Mission Critical Solutions (MCS), an incumbent contractor and 8(a) business, was not awarded a follow-on contract. Instead, the contract was set aside for and awarded to a different 8(a) business. MCS first filed a protest with the Government Accountability office. Because MCS was both an 8(a) and HUBZone business, it argued that the HUBZone program has priority over the 8(a) program. Under this argument, the contract should been competed for by HUBZone businesses and not 8(a) businesses. The SBA argued that the programs were in parity, so the contracting officer could choose which program to set-aside under.

The GAO sustained MCS's protest and priority arguments. Shortly thereafter, the DOJ released a memorandum disagreeing with the GAO and stating that the SBA's own interpretation that the provisions were in parity was reasonable. In doing so, the DOJ noted that GAO interpretations are not binding on executive agencies. MCS then protested the award in the Court of Federal Claims based on the same arguments.

To resolve the priority question, the court first looked at the language of the HUBZone statute, which provides in relevant part, that "[n]otwithstanding any other provision of law" "a contract opportunity shall be awarded pursuant to this section" to qualified HUBZone businesses. The court then looked at the language in 8(a), which discusses a contract offered under for award under that section. After a lengthy analysis, the court held that the HUBZone language was mandatory – requiring a contract to be competed for by HUBZone businesses whenever the program's criteria was met. In contrast, the court found the 8(a) language as providing a choice of whether to award the contract under 8(a) when the program's criteria were met. Therefore, the HUBZone program requires that a contracting officer first determine whether the HUBZone criteria are met before awarding a contract under another SBA program.

In August of 2010, the Court of Federal Claims addressed this issue again in *DGR Associates, Inc. v. United States*. DGR challenged an Air Force 8(a) set-aside contract for not giving priority to HUBZone businesses. Unlike MCS, DGR was a HUBZone business but not an 8(a) business. The court stated that it would adhere to its MCS decision that the language in the HUBZone program mandates its prioritization over the 8(a) program, as well as other SBA programs. A contracting officer cannot set-aside a contract for an 8(a) business, or another other SBA program, until that officer has determined that the

conditions in the HUBZone program are not satisfied.

Notwithstanding both the MCS and DGR cases, some executive agencies continue to rely on the DOJ memorandum, refusing to prioritize one program over another. Both the Air Force and the Defense Commissary Agency have relied on the DOJ memorandum when choosing to set-aside awards under other SBA programs without determining if the HUBZone criteria are met. Neither of these latest matters have come before a court yet, but in light of the MCS and DGR decisions, if the protests are filed in the Court of Federal Claims it's likely the court would defer to its previous priority determinations.

The continuation of this line of cases demonstrates that, until the executive agencies cease their reliance on the DOJ's opinion, the conflicts between the DOJ/agencies and the GAO/courts will continue regarding the SBA program priorities. Because some agencies are awarding contracts under 8(a) or other SBA programs without first determining if the HUBZone criteria are met, the awardees may face an increased likelihood of protest – resulting in a delay in the work under the contract.

THE LEAD-BASED PAINT TRAP

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Lead-based paint is a recognized source of hazardous lead dust and chips that can harm adults and children. Remodeling or repair activities like sanding, cutting, and demolition can generate hazardous lead dust and chips when performed where lead-based paint is present. As a result, federal law has endeavored to protect the public from harmful exposure by, among other things, requiring disclosure of the presence of lead-based paint in homes built prior to 1978.

Recently, the federal Environmental Protection Agency (EPA) extended protection from possible adverse lead exposure to include both "target housing" (i.e. homes built prior to 1978) and "child-occupied facilities". A "child-occupied facility" is any building constructed prior to 1978 visited regularly by the same child under 6 years of age, on at least two different days within any week. Under the EPA's new rule, contractors performing work on a structure built prior to 1978 must carefully assess whether the anticipated project involves target housing or a child-occupied facility to avoid civil penalties and liabilities. If the project falls within the new rule, a contractor must be certified and follow specific work practices to prevent lead contamination. See 40 CFR 745.80, Subpart E.

To comply with the federal law, the 2009 Oregon legislature enacted ORS 701.505 to 701.520 and 701.995. Under ORS 700.510 a contractor may not perform lead-based paint activities or lead-based paint renovation unless the contractor is licensed by the CCB to perform such work and complies with several regulations requiring disclosures that must be made to the owner of a target facility or child-occupied facility and signage at the project describing the work to be performed and anticipated completion date.

"Lead-based paint activities" is defined with reference to federal regulations and includes inspection, risk assessment and abatement. 40 C.F.R. 745.223. "Lead-based paint renovation" is defined with reference to the federal definition of "renovation". Such work is defined expansively as follows:

> Renovation means the modification of any existing structure, or portion thereof, that results in the disturbance of painted surfaces, unless that activity is performed as part of an abatement as defined by this part (40 CFR 745.223). The term renovation includes (but is not limited to): The removal, modification or repair of painted surfaces or painted components (e.g., modification of painted doors, surface restoration, window repair, surface

preparation activity (such as sanding, scraping, or other such activities that may generate paint dust)); the removal of building components (e.g., walls, ceilings, plumbing, windows); weatherization projects (e.g., cutting holes in painted surfaces to install blown-in insulation or to gain access to attics, planing thresholds to install weather-stripping), and interim controls that disturb painted surfaces. A renovation performed for the purpose of converting a building, or part of a building, into target housing or a child-occupied facility is a renovation under this subpart. The term renovation does not include minor repair and maintenance activities.

If an anticipated project falls within the new law a contractor must not only be licensed by the CCB to perform the work but also must comply with work practice standards, record keeping and reporting standards promulgated by the Oregon Department of Health and Human Services (DHS). The DHS standards can be found on their website: http://www.oregon.gov/DHS/ph/leadpaint/docs/proposedtext.pdf. Failure to comply with the new law can lead to a fine of up to $5,000 for each violation, as well as civil liability. Since there are voluminous requirements for performing work under the new law, the fine under ORS 701.995 has the potential to be significant if numerous violations are found.

The above requirements are new under Oregon law. As such, the Oregon Courts have not yet had an opportunity to apply or construe it. As a result, there are some questions that have not yet been answered. For example, what is the scope of a contractor's duty to inquire whether the building they have been hired to renovate is a child-occupied facility? Similarly, if such a duty exists how is a contractor supposed to find out whether the contractor is renovating a child-occupied facility?

On most projects, it will likely be apparent; however, some projects will undoubtedly involve mixed uses or common areas in which children under six are present enough for the site to be considered a "child-occupied facility". The EPA regulations (40 CFR 745) explain that for common areas in public or commercial buildings which contain child-occupied facilities, the child-occupied facility encompasses only those common areas that are routinely used by children under age 6, such as restrooms and cafeterias. The EPA also explains that common areas like hallways, stairways and garages are not included because children only pass through such areas.

However, whether or not a contractor has an obligation to determine whether or not a project site may include a child-occupied facility is not answered expressly in the text of the new law or text of relevant federal regulations. Instead, the EPA provides comments about its regulations that can be found in the Federal Register, Vol. 73, No. 78, pg. 21707 that confirm the intent of the regulations is to impose an obligation on the renovation contractor to determine whether a building or any portion of it involves a child-occupied facility. The only guidance provided by the EPA to help contractors discharge this obligation is to suggest that a contractor should pay attention to the name of a building, observable evidence that indicate children are present and signage that may indicate child care is provided on site. The few examples provided of things a contractor should be on the lookout include the following:

- A stand-alone child care center is likely to have a name that suggests that it provides child care.
- The status of a child-occupied facility should be obvious upon entering the center.
- Child care centers in office buildings are likely to have informational signs posted and the centers are likely to be identified in the building directory.
- Elementary Schools are likely to have kindergarten classrooms.

The EPA explains that the contractor should also inquire about the presence of a child-occupied facility when contracting to perform

renovation services in a public or commercial building. However, the EPA also explains that a contractor cannot rely solely upon a statement by the building owner or manager that there is no child-occupied facility in the building in the face of evidence to the contrary.

As a result, it makes sense for contractors who work on any structure built prior to 1978 to address this issue in their contract with the project owner by both requiring certification as to whether any portion of a project involves a child-occupied facility and conducting an onsite inspection to be sure there isn't any evidence that children under the age of 6 may be present. It may also be worthwhile to simply acquire the annual $50 Certified Lead-Based Paint Renovation Contractor's License, take the training and treat every job involving a pre-1978 structure as if it was a child-occupied facility. Additional information about the new requirements and available classes for the training can be found at the following links:

http://www.epa.gov/compliance/resources/newsletters/civil/enfalert/leadpaint.pdf

http://www.oregon.gov/CCB/lead-based-paint.shtml

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2010 Legislative Recap

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The Oregon Legislature met in special session in 2010, and spent a substantial amount of time working on legislation that could have affected the construction industry in Oregon. Ultimately, however, only two bills of significance emerged from the special session, although some will arise from the grave in 2011, including a so-called "Buy American" bill that will likely include local hiring preferences and mandates of Oregon or U.S. produced goods. The following is a brief re-cap of the legislation that passed in the 2010 special session.

HB 3699 – Joint Venture Licensure

This was a cleanup bill that corrected an inadvertent deletion from ORS Chapter 701, which apparently occurred in the 2007 legislative session. On July 1, 2010, if nothing had been done, any joint venture would have had to obtain a contractor's license, including bonding and insurance, before it could submit a bid or proposal, even if one or both members of the JV were already licensed. This bill re-inserted language that allows a joint venture to submit a bid or proposal without obtaining an independent license, so long as at least one of the partners is properly licensed and endorsed in the correct category of work. A joint venture that is awarded a project must still obtain a separate license prior to the start of work.

HB 3689 – Lien Law Revisions

In the 2009 Oregon legislature, a bill was introduced – HB 2366 – that would have turned Oregon's lien law literally upside down, at least for liens that affect residential properties. The bill would have essentially changed Oregon from a so-called "direct-lien" state to a "derivative-lien" state. Lienholders currently have direct foreclosure rights against the subject property, so long as they can prove the validity of the amount claimed. Subcontractor and supplier lien rights are not eroded even where a property owner has already paid a prime contractor for the work for which the lien is placed. The 2009 legislation would have changed that. The bill would have invalidated subcontractor and supplier liens where the property owner could demonstrate that he or she had already paid the prime contractor.

Needless to say, this approach did not sit well with subcontractors and suppliers who have

come to rely on the strength of the current system – particularly in the face of the recession that started in late 2008. The bill's sponsor, Rep. Paul Holvey, eventually agreed to pull HB 2366, and put together a work group that spent several months crafting a much more narrow approach to the "double-pay" scenario. The result of the work group is embodied in HB 3689.

This bill does three basic things. First, it cleans up ORS 87.035, a consumer protection statute enacted in the 2003 legislature, by eliminating the ability for new home purchasers to waive the protections set forth in the rest of the statute. In other words, it requires home sellers to comply with the provisions of the law, which are designed to protect against liens filed after the closing of the home sale. This is most often accomplished via the purchase of a form of title insurance that protects the purchaser against a subsequently-recorded lien.

Second, the bill eliminates subcontractor or supplier lien rights on remodeling projects if the sub or supplier provides or contracts to provide "services, labor, materials or equipment" to a person who is not a licensed contractor at the time the services, labor, material or equipment are first procured for a given project. In other words, on remodels, subs and suppliers must now begin checking the contractor's license status prior to contracting with or selling to upstream parties in the contracting chain. If the sub or supplier sells to an unlicensed contractor, the sub or supplier will have no lien rights for that remodel project.

Third, the bill allows the Construction Contractors Board to place a contractor on probation if the contractor is found to have abused the deposit process by accepting a deposit of more than 50 percent of the contract price for a project and the contractor "fails to perform diligently" or fails to refund the deposit. This requirement only applies to "Home Improvements" which is a new defined term in ORS 701.005.

Thus, the bill takes a much more narrow approach to protecting consumers by attempting to focus on the behavior of contractors that often leads to unpaid bills and the need for liens in the first place, rather than a wholesale elimination or limitation on contractors' lien rights.

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