Construction Law Newsletter

Published by the Section on Construction Law of the Oregon State Bar

ISSUE No. 40 June, 2011

TIPS FOR MEDIATION SUCCESS

Howard Carsman

Mediation has become an expected step in construction litigation, particularly construction defect cases. What once was innovative is now ordinary, and multiple mediation sessions for a single case are the norm. Construction litigators are regularly called upon to trade their trial hats for mediation berets.

Every stage in litigation has its unique characteristics and requires its own set of skills. Taking a good deposition can be the result of years of practice. Not everyone can prepare a good dispositive motion, and trial stands at the apex of litigation as requiring certain talents and techniques that set it apart from all other stages of litigation.

What then of mediation? While anyone can attend one and sit in a caucus, the real question is how can counsel improve the likelihood of a successful outcome for the client? The following are but a few suggestions.

Early Mediator Involvement

Some litigators complain that today's construction case takes more than one mediation session. They note that the first session is often taken up with preliminary matters or simply getting clarity on the basic facts and issues.

The typical construction or construction defect case is not simple. Multiple parties, multiple issues, insurance coverage, and a room full of lawyers make for a challenging mediation under the best of circumstances. Crowded calendars can push preparation to the last minute.

To increase the mediation's efficiency, if possible, see to it that the mediator gets involved early in the process, well before the mediation session. By meeting with each party and counsel soon after engagement, the mediator can get through preliminary matters, seek out the common facts, and identify the issues that are key to settlement.

These one-on-one meetings also give the clients an opportunity to tell their story. Most clients want to be heard, but sometimes the mediation caucus offers only a brief meeting with the mediator or, for the bigger parties, the client gets only a small portion of the caucus to tell its story. The pre-mediation meeting gives the client an unrestricted audience with the mediator.

Armed with the Facts and Law

As a mediator, I have on countless occasions sat in caucus with lawyers that leave their most basic advocacy skills at the office. They have only a general understanding of the facts. They argue that their client has no liability, or someone else does, or that their client should get everything it asks for but have no trial-type evidence to support their position.

Within reason, prepare for mediation as if it were trial, or at least a hearing on summary judgment. Be ready to give the mediator trial-type evidence to support your position. If there is a specific case on a key point, have it with you. In short, educate the mediator as you would educate the judge, and the mediator can then do a better

job when he or she caucuses with the opposing party.

Your Client's Underlying Interests

Yes, money is the legal tender for settlement. However, we all have had occasion to see other non-monetary factors have a big impact on the negotiations.

It is important to become familiar with these drivers, which are frequently emotional. While some lawyers attempt to minimize these with the client, they should instead be acknowledged and, if possible, shared with the mediator.

The monetary aspect of the potential settlement will also often have an underlying interest upon which it is based. The most obvious example is the HOA that wants the repairs done. In other cases, such as a traditional delay or acceleration claim, different interests may be at play, such as the survival of the company. In either case, understanding what is beneath the settlement position often holds the key to a successful negotiation.

Mediation Advocacy

In caucus, giving the mediator your opening statement at trial isn't likely to advance the ball much. In a joint or open session, a scorching presentation probably won't warm up the opposing party toward settlement. Mediation is a different ball game than trial, and while it may seem elementary, mediation requires a different form of advocacy.

When talking with opposing counsel, particularly when the clients are present, avoid highly argumentative, trial-type dialogue. Try instead to present your position in more neutral terms, acknowledging that the opposing party's position is legitimate even if in error. In other words, treat the opposing party with respect, whether you want to or not.

When talking to the mediator in caucus, and in addition to talking about the strengths of your case, acknowledge its weaknesses. No case is perfect, and no good mediator is dumb enough to accept counsel's argument that counsel's case is just that.

Prepare the Client

Counsel's job is to prepare the client for mediation. Preparing the client includes shaping the client's expectations. Counsel's job starts with a realistic, objective assessment and a frank discussion of what a trial would actually be like for the client.

If the client is coming into mediation with unrealistic expectations, it is likely that counsel bears much of the responsibility. The mediator should not be the first person that gives the client an objective, realistic view of its case.

Client preparation includes exploring the BATNA and WATNA (Best and Worst Alternatives To a Negotiated Agreement), and the in-between options. It only makes sense that a client needs a sound basis for evaluating settlement offers and making the best decision it can under the circumstances of its case.

Conclusion

Some believe that mediation has become routine, a process to walk through until a settlement is eventually reached. Yet, mediation can be made more effective and efficient if it is approached with the same attention and preparation as any other important stage of litigation. While the mediator may be given much of the credit, or blame, for the mediation's outcome, counsel often holds the key to its success.

RESIDENTIAL CONSTRUCTION LIENS: LABORER V. OWNER

Dan Duyck
Whipple & Duyck

Recently I have been confronted with a recurring fact scenario involving a residential contractor that takes advantage of both customers

and employees. The customers pay the contractor, but the contractor does not pay his employee. Frequently the work is defective. With the contractor out of the picture, there is a natural tension between the unsatisfied owner and the unpaid employee. One source of the tension is the debate over the validity of the employee's construction lien rights – the subject of this article.

FACTUAL BACKGROUND: Contractor agrees to perform construction work for Owner on a residential project. Typically the agreement is for a smallish amount, say $4-10,000. Contractor hires Laborer, frequently a day laborer with limited sophistication and employed for just a few days. Owner pays Contractor. Contractor does not pay Laborer. Contractor is typically not licensed with the CCB and frequently cannot be found.

ISSUE: Can Laborer file a construction lien against Owner's property?

LABORER'S PRIMA FACIE ARGUMENT: Laborer argues that he has a lien because he is a "person" performing "labor" as contemplated by the lien statutes. ORS 87.010(1) reads as follows:

> "Any person performing labor upon, transporting or furnishing any material to be used in, or renting equipment used in the construction of any improvement shall have a lien upon the improvement for the labor, transportation or material furnished or equipment rented at the instance of the owner of the improvement or the construction agent of the owner."

Oregon law has long supported the lien rights of laborers/employers. See, e.g., *Pilz Killingsworth*, 20 Or 432, 26 P2d 305 (1891). Further, Laborer is an employee of a contractor, and is therefore exempt from any CCB licensing issues that might otherwise prevent him from filing and ultimately foreclosing upon a lien. ORS 701.010(10).

OWNER'S COUNTERARGUMENT: Owner argues that Laborer cannot have a lien because Laborer did not give Owner a Notice of Right to Lien. ORS 87.021(1) reads as follows:

> "Except when material equipment, services or labor described in ORS 87.010(1) to (3), (5) and (6) is furnished at the request of the owner, a person furnishing any materials, equipment, services or labor described in ORS 87.010 (1) to (3), (5) and (6) for which a lien may be perfected under ORS 87.035 shall give a notice of right to a lien to the owner of the site."

It follows that Laborer has no lien rights because Laborer did not give Owner a Notice of Right to Lien.

LABORER'S REBUTTAL ARGUMENT: Laborer's rebuttal argument is that he is not required to give a Notice of Right to Lien. Laborer is working for Contractor, and Contractor is providing labor at the request of Owner. For purposes of notices, the Contractor and Laborer should be considered to occupy the same "at the instance of the owner" position under the statute and supported by the *Pilz* decision. After all, it would be an absurdity to expect all laborers working for a prime contractor to give the residential project owner a Notice of Right to Lien.

OWNER'S SURREBUTTAL ARGUMENT: Owner's surrebuttal argument is that if Laborer wants to bootstrap himself into Contractor's position, then Laborer's lien claim can only survive if the Contractor followed all statutory requirements, including providing the statutory "Information Notice to Owner." ORS 87.093(1). Frequently, the Contractor has not complied with any statutory requirements.

DISCUSSION: The above scenario is a difficult situation for both Laborer and Owner. In my practice I have encountered factual variations that further complicate the basic scenario. Here are some examples: 1) Owner knowingly uses an unlicensed contractor in order to obtain a more favorable price for the work; 2) Laborer is not in a financial position to pursue a construction lien, including the potential downside of an adverse decision and accompanying attorney fee award; and 3) Owner is sympathetic to the plight of the unpaid employee, but is not in a position to pay

twice for the work, especially if the work is defective.

The notice issues can be avoided when the construction involves a "commercial improvement" instead of a "residential building." ORS 87.021(3). Thus, Laborer in the above situation is able to file a lien against a commercial improvement.

CONCLUSION: All things being equal, Owner has the stronger statutory argument. However, Owner's position can be weakened by various factors, such as knowingly using an unlicensed contractor or being aware that the Laborer was not being paid. Also, the Owner should be concerned that a fact finder might feel more sympathy for the Laborer's plight than for the owner's strict statutory defense.

The author wishes to acknowledge the assistance of Z. Hanah Riley during her externship at Whipple & Duyck, P.C.

NEW TAX LAW WILL IMPOSE A SIGNIFICANT BURDEN ON CONTRACTORS

Tyler Storti
David Gilbert
Stewart Sokol & Gray

For the past several years, construction industry groups have hotly opposed a new tax law that will require the government to withhold 3% from all payments to contractors who provide goods or services to the government. The law is predicted to have a significant negative effect on general contractors in particular, so construction attorneys should pay close attention to the law and its status in order to appropriately advise their clients. However, affected parties can breathe a sigh of relief because the IRS recently delayed the implementation of this new law, pushing its effective date back one year to January 1, 2013. 26 C.F.R. § 31 (May 6, 2011).

The law is included in section 511 of the Tax Increase Prevention and Reconciliation Act of 2005, which amended section 3402(t) of the Internal Revenue Code to require the mandatory withholding. The law applies to federal, state and local governments with annual budgets of more than $100 million, and requires the 3% withholding from every contract payment exceeding $10,000. The 3% is held by the government until the contractor files its income tax return and pays its taxes, which could be many months after the contractor's performance of the contract work is completed.

The law is intended to collect under-reported tax revenues and to increase the tax compliance of entities that perform public contracts. In part, the new law is in response to a 2004 Government Accounting Office ("GAO") report that "[Department of Defense] and IRS records showed that over 27,000 contractors owed about $3 billion in unpaid taxes as of September 20, 2002." The GAO report also stated that in some cases, the unpaid taxes were the result of "abusive and potentially criminal behavior."

The new law has been widely criticized. Critics emphasize the significant administrative costs the law will impose on both governments and the private entities that contract with them. These expenses will include: (1) capital expenses for system changes (because neither governments nor private entities have accounting systems set up to handle withholding in this manner); (2) annual compliance costs (additional employees will be needed to implement the additional administrative burden); and (3) finance costs (because the 3% withheld will significantly interrupt cash flow). For example, in a 2008 report from the Department of Defense, it was estimated that it would cost the Department more than $17 billion in the first five years to comply with the withholding requirement, which likely exceeds any expected revenue gains due to increased tax compliance.

Other commentators point out that the law will also cost government bodies in the form of higher bid amounts from contractors who will seek to pass along their increased costs to the government. Some say that the tax compliance

issues could be better resolved by a more rigorous enforcement of existing tax laws. The new law applies to all contractors providing goods and services to the government. It does not narrowly target known tax evaders. Thus, the solution is much broader than the problem it attempts to solve.

Critics also note that the law taxes entities even if they do not owe any taxes. Many general contractors are S-corporations or limited liability entities that owe no tax themselves, because the tax obligations of these entities are passed through to the individual owners. Thus, the 3% will be withheld from entities that do not owe taxes and will greatly complicate the tax returns of the individual owners of these entities.

While general contractors are far from the only entities to be affected by this law, they will be some of the most negatively affected because of their often thin profit margins, which commonly do not exceed 3% of the total contract price. For example, under the law, $300,000 will be withheld from payments on a $10 million contract. If the general contractor achieves a 2.5% profit after paying for labor, materials, equipment, subcontractors, and other ordinary business expenses, that will net $250,000. The tax on the net revenue generated is at most 35% (the maximum corporate income tax rate), which means that the maximum tax owed by the general contractor for the $10 million project is $87,500 (35% of $250,000). Under the new law, the government will withhold $300,000 for only $87,500 in tax obligations, thus depriving the contractor of the use of over $212,000 until the contractor pays its taxes after the end of the year.

In addition, the 3% withholding will tighten cash flow, and reduce general contractors' ability to pay for subcontractors and suppliers to finish the work. As currently drafted, this withholding provision does not require the withholding to "flow down" to lower tier subcontractors. While governments must withhold 3% of their payments to the parties with whom they directly contract, if those parties subcontract part of the work, they need not withhold 3% of the subcontractor's payments. Standing alone, that may mean that subcontractors could be paid in full for their work without regard to the 3% withholding. However, as a practical matter, it is highly likely that general contractors will include similar withholding provisions in their subcontracts to improve the general contractors' cash flow and, if so, the law will impact lower-tier subcontractors as well.

Since the law will drastically affect general contractors who perform public works projects, the Associated General Contractors of America, the National Utility Contractors Association, and other construction contractor industry groups have mobilized lobbying efforts in stern opposition to the new law. Those groups, along with approximately 90 other industry groups (including the American Institute of Architects, American Society of Civil Engineers, and others with ties to the construction industry), have also joined the large ad hoc group called the Government Withholding Relief Coalition, which has been actively lobbying for the law's repeal. The AGC, NUCA and the Relief Coalition support multiple bills currently under consideration to repeal the law, including H.R. 674 and S. 89 and 164.

The law was originally scheduled to apply to payments made on or after January 1, 2011. Now, the effective date is scheduled to be January 1, 2013. Interestingly, the IRS's commentary that accompanied the final regulations noted that the reason for the delayed effective date is that many government entities that commented on the draft regulations stated that they would need at least 18 months from the issuance of the final regulations to be able to comply. The IRS also noted that, during the comment period, many commentators requested additional guidance on the application of the law to prime contractors, subcontractors, and payment administrators in specific factual situations. The IRS, however, declined to give further guidance.

With the multiple delays in the law's effective date and concerted lobbying effort aimed at its repeal, there is some question whether the 3% withholding law will ever go into effect.

However, as things currently sit, the safe assumption is that the law will go into effect, and government entities and private firms that contract with them need to soon begin preparing for its implementation.

OREGON BID PROTESTS: PITFALLS AND CHECKLISTS

Tara Mellom
Scott-Hookland LLP

A multitude of construction and service contracts are let each year by various public bodies in Oregon. One commonality of these contracts is the opportunity to protest the award of the contract to the low bidder. The following is a brief summary of how to approach a bid protest and some of the most common pitfalls awaiting bidders and/or their lawyers in the process.

1. Identify the Public Body that Let the Contract.

The list of potential public entities that can let a public contract in Oregon is immense. However, it is imperative to promptly identify the public body that let the contract. This is because the type of public body/contracting agency will dictate which sets of public contracting rules the disappointed bidder will need to comply with.

For example, if the public body is a state agency, it is highly likely that the disappointed bidder will be subject to the Department of Administrative Services public contracting rules found in OAR Chapter 125-249, et. seq.[1] Alternatively, if the public body is not a state agency (for example a county, municipality, or school district), it is likely that the disappointed bidder will instead be subject to the Department of Justice public contracting rules found in OAR Chapter 137-049, et. seq.[2] Since each set of public contracting rules is different, it is critical to confirm that you are starting your bid protest analysis with a full set of the applicable rules.

2. Identify the Applicable Timeline for Asserting the Bid Protest.

Public contracting rules do not typically provide more than a few days' window for protest periods. The contracting agencies have a vested interest in promptly proceeding forward with their projects. Therefore, the protest time periods are intentionally minimal and require immediate attention.

A. Maintenance of Available Remedies.

Public contracting clients frequently inquire why these time deadlines are so critical. One answer is that the failure to timely submit a proper bid protest may significantly reduce the potential damages a disappointed bidder can recover from a valid protest.

If a disappointed bidder timely and properly files a valid bid protest with the contracting agency, its potential remedies are generally either the award of the contract to the protesting bidder or the contracting agency may reject all project bids and re-bid the project. See ORS 279C.395. However, if the disappointed bidder fails to timely and properly file a valid bid protest and the contact is awarded, the disappointed bidder's remedies are generally limited to recovery of its bid preparation costs (i.e. no recovery for lost profits). *Hawaiian Dredging Const. Co. v. U.S.*, 59 Fed. Cl. 305, 317 (2004); *Norfolk Dredging Co. v. U.S.*, 58 Fed. Cl. 741, 758–759 (2003), *reversed and remanded on other grounds Norfolk Dredging Co. v. U.S.*, 375 F.3d

[1] State agencies are bound by the DAS rules for public contracting, unless they opt out of such provisions and adopt their own public contracting rules. ORS 279A.050(2). For example, the Oregon Department of Transportation has adopted its own set of public contracting rules. ORS 279A.050(3).

[2] Similar to state agencies, other contracting agencies are bound by the Attorney General's model rules for public contracting, unless they have opted out of the application of certain provisions by the adoption of their own public contracting rules. For example, Multnomah County has adopted the Multnomah County Public Contract Review Board Rules.

1106 (2004). That is why on some large projects, such as multi-season construction projects, it makes sense not only to promptly file the written bid protest with the contracting agency, but also to file with the court for a preliminary injunction of the award to the designated bidder. Such an injunction, if awarded, serves to both prevent the contracting agency from expediting the award to avoid the protest and to maintain the status quo as to available remedies for the disappointed bidder.

B. Public Improvement Contract Example.

ORS Chapters 279, 279A, 279B, and 279C govern public contracting in the State of Oregon and establish the Public Contracting Code. ORS 279A.020 designates the organization of these chapters. Stated simply, ORS 279C governs public contracting involving public improvements and other construction services, including public contracting involving architects, engineers, land surveyors and related services. In turn, ORS 279B governs all other public contracting and is generally referred to as the public procurement provisions. For purposes of this article, our focus will be on ORS 279C – construction-related public contracting.

Following the solicitation process, bid opening, and the determination of intent to award the contract, the contracting agency will issue or post a notice of intent to award the contract ("Notice of Intent"). The Notice of Intent must be issued or posted at least seven (7) calendar days[3] before awarding a public improvement contract.

The issuance or posting of the Notice of Intent triggers the disappointed bidder's limited protest period. ORS 279C.375(2). Therefore, when a client contacts you, it is good practice to immediately determine if the specific project's Notice of Intent has been issued or posted. It is also prudent to simultaneously review the solicitation documents (and any addenda thereto) to determine whether the contracting agency expanded or reduced the Notice of Intent/protest period from the typical seven (7) day period. These two inquiries will permit you to properly calendar the matter for timely submission of the written bid protest.

Do not anticipate or expect that the contracting agency will grant an extension of this period. It is highly recommended that protests be hand delivered to the contracting agency and a receipt of such delivery be obtained from the designated representative for the contracting agency. This will assist in later timeliness arguments from the contracting agency or other bidders.

3. Is Your Client an Adversely Affected or Aggrieved Bidder?

Not all bidders qualify to protest the award of a public contract. Rather, the disappointed bidder must qualify as an "adversely affected or aggrieved bidder." For example, under the DOJ rules, a bidder is deemed to be adversely affected or aggrieved only if the bidder is eligible for award of the contract as the "responsible bidder submitting the lowest responsive bid" and is next in line for award. OAR 137-049-0450(4). In other words, a disappointed bidder is only permitted to submit a protest if it can claim that all other lower bidders are ineligible for award of the public contract due to lack of responsiveness, lack of responsibility, or a substantial violation of the solicitation terms.

The terms "responsible bidder" and "lowest responsive bid" are terms of art, and must be carefully reviewed when determining if a disappointed bidder has a viable protest. The responsibility of a bidder is determined based on a set of criteria found in ORS 279C.375(3)(b). A disappointed bidder may assert in its protest that another bidder(s) fails to meet one or more of these established criteria and therefore is not the lowest responsive and responsible bidder. This would be potential grounds for a valid bid protest.

When reviewing a bidder's responsibility, you should promptly request a copy of the other

[3] This seven day period can be reduced, if the contacting agency determines that seven days is impractical under the rules adopted under ORS 279A.065. ORS 279C.375(2).

bidders' Responsibility Determination Forms from the contracting agency. See ORS 279C.375(3)(c).

Similarly, the lowest responsive bid is determined by a bidder's conformance with the contract's solicitation requirements. In order to protect the competitive nature of public contracting, a contracting agency must require strict conformance with the solicitation's material terms. ORS 279C.395. OAR 137-049-0350 establishes how solicitation mistakes by a bidder may be addressed. The contracting agency must reject a bid if the mistake is evident on its face and the intended correction is not evident or cannot be substantiated from the other documents submitted. OAR 137-049-0350(3). For example, if a bidder fails to timely submit its First-Tier Subcontractor Disclosure form (as required by ORS 279C.370), the next lowest responsive and responsible bidder may protest the award due to lack of responsiveness.

There are quite a few issues that may result in a bid being declared non-responsive. Therefore, if your client is the next lowest bidder, you should request a copy of the proposal submitted by the winning bidder. The contracting agency must make all bids available for public inspection, except to the extent it contains trade secrets or confidential proprietary data. OAR 137-049-0330.

As a general rule, a bid protest is more likely to succeed on a claim of lack of responsiveness than a claim of non-responsibility. This is because the requirements for the public body's determination of responsibility are less strict and permit broad discretion on the part of the contracting agency. For example, the contracting agency may accept information after the bid opening that supports the bidder's responsibility criteria. Further, the contracting agency's responsibility determination will not be disturbed absent proof of an abuse of discretion.[4] Therefore, it is highly recommended that disappointed bidders look for violations of both responsiveness and responsibility, rather than simply rely on one of these elements.

[4] *See Hanson v. Mosser,* 247 Or 1, 10, 427 P2d 97 (1967), *overruled on other grounds,* 256 Or 485 (1970), (*quoting Inge v. Board of Public Works,* 33 So 678, 681 (Ala 1902), and *citing State v. Richards,* 40 P 210 (Mont 1895)).

4. Identify Format and Delivery Requirements of Protest

If the disappointed bidder meets the requirements of being an adversely affected or aggrieved bidder, the next step is to confirm the format and delivery requirements for the bid protest. The DOJ rules on protest formatting are found in OAR 137-049-0450 and will be discussed in this article for purposes of example. However, as noted above, it is critical to confirm that you are using the correct public contracting rules for the particular contracting agency involved.

Under OAR 137-049-0450(4), a protest must meet the following elements:

(1) Written;

(2) Specify the grounds upon which the protest is based (*i.e. non-responsiveness, non-responsibility, both, or a violation by the contracting agency of an applicable public contracting rule*); and

(3) Timely delivered in the manner set forth in the solicitation documents, or addenda thereto.

Following receipt of a timely and properly filed bid protest, the contracting agency head or designated representative must either settle the protest or promptly issue a written decision on its determination of the protest. OAR 137-049-0450(6-7).

If an aggrieved bidder believes that the protest was improperly denied, then he should immediately consider filing a preliminary injunction with the appropriate Court, prior to award of the contract, to permit judicial review of the decision and to maintain all available remedies, as discussed above.

The requirements of this process are not overly strenuous in nature. Rather, the difficulty lies in timely identifying the pertinent public contracting rules, obtaining the necessary public records, and delivering the written bid protest in

the required manner. It is easy to underestimate the time necessary to complete this process, especially when you receive the potential protest on the final day of the protest period.

MERS UPDATE

Katie Jo Johnson
McEwen Gisvold LLP

A significant amount of attention in relation to real property foreclosures remains focused on Mortgage Electronic Registration Systems, Inc. ("MERS"), both within the legal community and throughout general media. For those unfamiliar with MERS, it is essentially a clearinghouse for securitized loans. MERS boasts its purpose and function on its website (http://www.mersinc.org/about/index.aspx): "MERS acts as nominee in the county land records for the lender and servicer. Any loan registered on the MERS System is inoculated against future assignments because MERS remains the mortgagee no matter how many times servicing is traded."

An enticing premise, but one that is not holding up to increased scrutiny in the context of non-judicial foreclosures, calling into question MERS's assertion that it is the "mortgagee" of a loan registered on its system. A "mortgagee" is by definition a person or entity that lends money to another (the "mortgagor") to purchase property, and holds title to the property to secure the loan until it is satisfied. That title is either held as a mortgage or, commonly, a trust deed (in which the mortgagee is designated as the "beneficiary"). A trust deed is often utilized in Oregon because it allows the beneficiary to foreclose the trust deed outside of court through the statutory non-judicial foreclosure procedure set forth in ORS 86.705, *et seq.*, known as the Oregon Trust Deed Act.

The policy behind the Oregon Trust Deed Act is to "protect grantors from the unauthorized foreclosure and wrongful sale of property, while at the same time providing creditors with a quick and efficient remedy against a defaulting grantor." *Staffordshire Inv., Inc. v. Cal-Western Reconveyance Corp.*, 209 Or App 528, 542, 149 P3d 150 (2006). That balance can only properly be struck when the beneficiary strictly complies with the requirements of the Oregon Trust Deed Act. *Id.*

When a loan is registered on the MERS system, MERS is listed on the trust deed as the beneficiary, "solely as nominee for Lender." In a recent opinion, Judge Owen M. Panner fell in line with a recent line of cases finding that the nominee relationship is that of an agent for the true beneficiary: the lender. *Hooker v. Northwest Trustee Servs., Inc.*, 2011 US Dist LEXIS 57005, *7-8 (D Or May 25, 2011) (stating that MERS holds only legal title to the trust deed, acts solely as nominee for the named lender and takes action as nominee only in specifically identified circumstances). The nominee relationship itself is not necessarily a concern, since it does presumably allow MERS to take certain actions on behalf of the lender as beneficiary. *Id.*, at *8.

Indeed, if the lender remained unchanged prior to foreclosure, there would conceivably be no issue with the lender, or MERS as its agent, foreclosing in compliance with the Oregon Trust Deed Act. But loans registered on the MERS system do not long remain with the original lender. Indeed, the entire purpose of registering a loan with MERS is to promote free transfer among lenders with a minimum of formalities, and even without paper records, including written assignment. And here is where the ideal of MERS and the reality of Oregon law collide: the Oregon Trust Deed Act requires that: "[t]he trust deed, any assignments of the trust deed by the trustee or the beneficiary and any appointment of a successor trustee are recorded in the mortgage records in the counties in which the property described in the deed is situated." ORS 86.735(1). And so, the very purpose of MERS conflicts with the express requirements of Oregon statutes.

As stated by Judge Panner: "It is apparent with the benefit of hindsight that the ability of

lenders to freely and anonymously transfer notes among themselves facilitated, if not created, the financial banking crisis in which our country currently finds itself." *Id.*, at *18 (citing Justice Page's dissent in *Jackson v. Mortg. Elec. Registration Sys.*, 770 NW2d 487, 504 (Minn 2009)). The precise reason that the MERS loan was found inappropriate for the non-judicial foreclosure process is because, "[b]y listing a nominal beneficiary that is clearly described in the trust deed as anything but the actual beneficiary, the MERS system creates confusion as to who has the authority to do what with the trust deed. The MERS system raises serious concerns regarding the appropriateness and validity of foreclosure by advertisement and sale outside of any judicial proceeding." *Id.*, at *16-17.

The import of *Hooker*, then, is that a MERS loan cannot be foreclosed outside of court without recorded assignments reflecting every change in lender/beneficiary. That may be enough for some critics, but what if a contractor tries to follow the statutory requirements for filing and foreclosing a construction lien as set forth in ORS 87.001 *et seq.*? The MERS system presents the same problem, from a different angle: the contractor must determine any and all parties with interest in the relevant property who are entitled to notice and who must be named in the foreclosure complaint. In the construction lien statutes, one of those parties is any mortgagee, a term currently defined for purposes of those statutes as "a person who has a valid subsisting mortgage of record or trust deed of record securing a loan upon land or an improvement." ORS 87.005(6).

While it is not explicit in ORS 87.005, a person who "has" a trust deed is the beneficiary, defined in ORS 86.705(1) as the "person named or otherwise designated in a trust deed as the person for whose benefit a trust deed is given, or the person's successor in interest." Therefore, the same confusion and difficulty in identifying the true lender/beneficiary of a MERS loan that prevents a statutory non-judicial foreclosure also could create issues for a contractor foreclosing a construction lien and attempting to send all required notices pursuant to ORS 87.025, ORS 87.039 and ORS 87.057 and to name all interested parties pursuant to ORS 87.060(7) in order to avoid a challenge to the foreclosure.

At least one court has recently determined that it is not necessary to name MERS in a foreclosure proceeding which requires all interested parties to be named when MERS was listed as nominee because MERS, "as mere nominee and holder of nothing more than bare legal title to the mortgage, did not have an enforceable right under the mortgage separate from the interest held by [the lender]." *Citimortgage, Inc. v. Barabas*, 2011 Ind App LEXIS 892, *15 (May 17, 2011) (citing largely to *Landmark Nat'l Bank v. Kesler*, 289 Kan 528, 216 P3d 158 (2009)). But, then, who does the contractor name? While MERS provides a searchable database providing servicer information (http://www.mers-servicerid.org/sis/), it is much more difficult, if not sometimes impossible, to identify the current lender/beneficiary.

Oregon's construction lien foreclosure statutes at present potentially punish a contractor attempting to foreclose a construction lien for an inability to identify what even those directly involved in the system may not be able to determine: the true lender/beneficiary. To correct this injustice, a bill currently making its way through the Oregon legislature would amend the definition of "mortgagee" in ORS 87.005(6) to clarify who exactly needs to receive notice pursuant to the construction lien statutes. Senate Bill 382 would amend the definition of "mortgagee" from "a person who has a valid subsisting mortgage of record or trust deed of record securing a loan upon land or an improvement" to:

> a person: (a)(A) Whose name and address appear as mortgagee or beneficiary in a mortgage of record or a trust deed of record that is recorded under ORS 205.234 with the county clerk of the county within which the property or improvement is located; and (B) That has a valid subsisting mortgage of record or trust deed of record that secures a

loan upon land or upon an improvement; or (b)(A) Whose name and address appear as the assignee of the mortgagee or beneficiary in an assignment of mortgage of record or a trust deed of record that is recorded under ORS 205.234 with the county clerk of the county within which the property or improvement is located; and (B) That has a valid subsisting mortgage of record or trust deed of record that secures a loan upon land or upon an improvement.

On June 1, 2011, the House recommended that Senate Bill 382 be passed with amendments and printed as B-engrossed.

While there appears to be a long and winding road ahead for the legislature, courts and practitioners to sort out the full impact and effect of MERS on foreclosure proceedings, the proposed legislation amending the definition of "mortgagee" in ORS 87.005(6) is a first step in allowing contractors to utilize construction lien foreclosure statutes as they were intended.

CHANGES TO RESIDENTIAL SPECIALTY CODE

Craig Wakefield
Tillamook County Planning Dept.

The 2008 Oregon Residential Specialty Code (ORSC) included new model code language requiring an exterior wall to be constructed in such a manner that it prevents the accumulation of water in the wall and provides a means of draining water that does enter the assembly to the exterior.

Testing and field studies point to water intrusion failures across various siding systems. As a result, the new requirement will be applicable to all exterior claddings regulated by Amendment R703.1.

The minimum code requirement is that a 1/8th inch space shall be provided between the exterior cladding and the water resistive barrier (WRB) placed over the frame or sheeted wall. This concept is more commonly known as a rainscreen. Furthermore, the code provision provides for six exceptions that address enhanced drainage WRB window pan flashing, claddings, remodeling and tested assemblies. For background and details on the R703.1 amendment you can view the document at the following URL:

http://www.cbs.state.or.us/external/bcd/programs/residential/2008ORSC/08ORSC_mid_cycle_R703_1_insert.pdf.

Contractor Implementation of ORSC R703.1

There are many different approaches an article on a new building code provision can take. A detailed analysis of the code provisions is one approach. An exposition on the technical aspects of new approved building products at the heart of the code provision is another. These are the "hard parts" of a building code treatise. The "soft parts" may be considered to be the contractors who must implement the code provision and the Building Codes Division who must provide the rationale behind the code provision.

The rainscreen concept is not new to the construction industry. High rise and commercial buildings have use rainscreens of one form or another for many decades. In commercial construction, rainscreens are highly detailed on plans, and their components are listed in the specification documents for each type of structure.

By contrast, there has been limited use of rainscreen systems in residential construction. Because of the added expense and technical nature of rainscreen systems, many residential contractors do not promote these systems and opt for what might be considered tried-and-true products and installations. Cost-conscious homeowners may not consider the more expensive systems, especially when there is no obvious aesthetic benefit.

Now that the rainscreen has become a required residential code provision, several camps of reaction among residential contractors have formed. There are contractors that embrace the rainscreen provision and have educated themselves and their crews to use new materials

and advanced methods in conformance with the code provision. For other contractors, skepticism about changing practices from long established methods has made for a difficult transition. The assertion that, "I don't have problems with my methods," is a common refrain. When trapped water within a wall system creates rot, the original contractor may not be called in to assess the extent of needed repairs. On the Oregon coast, there is a cottage industry of contractors that specialize in repairing water intrusion rot damage. It can be difficult to get a contractor to raise his hand and say, "my methods and practices are responsible for your rot problems".

Most craftsmen have spent their careers trying to make the exterior envelopes of their homes water-tight. Many are affronted by the rainscreen code provision's assumption that water will enter the wall assembly, and that a means for the water to drain must be provided.

The rainscreen provision has provided manufactures of cladding, water resistant barriers and flashing materials with a whole new market for proprietary products meant to comply with ORSC section R703.1. Residential contractors, on the Oregon coast in particular, have a wait-and-see attitude about most of the new products meant to be installed as part of the exterior envelope of a home. This skepticism comes from the fact that building contractors have to warranty their work with materials that may not have been on the market long enough to have the tried-and-true stamp of approval.

Adding to building contractors' skepticism is the fact that the Oregon Building Codes Division has announced that there will be changes to even these *new* code provisions in an upcoming code cycle.

Conclusion

ORSC Section R703.1 is the law of the land. Oregon building officials must oversee the implementation of the code provisions and establish policies and procedures for inspecting and approving exterior wall assemblies. Permit applicants must provide details in their building plans of how they intend to comply with these code provisions.

In order to produce durable homes, building contractors will have to incorporate the new code provisions into their best practices, including the training of their personnel in the use of new products.

As code organizations continue to grapple with challenges to public health and safety in the construction environment, building codes will continue to change.

PENDING CCB CHANGES

Oregon Construction Contractors Board

Effective July 1, 2011 the Construction Contractors Board (CCB) Dispute Resolution Services (DRS) program will make significant changes to its program.

For complaints filed on and after that date, DRS will provide only mediation services. If the parties do not settle the complaint, the complainant must go to court and obtain a court judgment before DRS can send it to the contractor's surety for payment.

This change is made necessary by the recent sharp slowdown in construction that resulted in a significant drop in the number of licensed contractors and the fees paid to the CCB.

To adjust to this drop in revenue, the legislature made significant cutbacks in the CCB's budget for the DRS program. This reduced budget recently was signed into law by the Governor.

The legislation and rules implementing the necessary changes are still being drafted. Parties interested in the DRS program should check the CCB website at http://www.oregon.gov/ccb for more information.

A Small Change in Oregon's Construction Lien Law

Doug Gallagher
Doug Gallagher Law Office

A small change to Oregon's Homebuyer Protection Act (ORS 87.007) may catch unwary sellers who permit construction lien claims against residential property.

An owner who sells new or substantially remodeled or repaired residential property that was completed within three months before the date of sale may find themselves facing additional costs and potential liability for failing to comply with the Homebuyer Protection Act ("HPA"). Due to a small change – the deletion of the option to obtain the purchaser's waiver of protection under the HPA – means that a law that has been on the books since 2003 is more likely to create liability or expense for the unwary seller.

The 2003 legislature added the HPA to the Oregon Lien Law to protect homebuyers from the risk of having to pay for construction work twice: Once as part of the purchase price, and then again to discharge construction liens that arose from pre-sale construction activities.

The HPA regulates owners who sell new residential property for $50,000 or more, or who have improved existing residential property for a contract price of $50,000 or more, that was completed within three months before the date of the sale. Residential property is defined as a single family dwelling, a condominium unit or a building of not more than four dwelling units. Under the Oregon Lien Law, the term "owner" includes not only fee title owners, but also owners of lesser estates and contract vendors.

A common scenario that the HPA is designed to avoid might involve an owner who performs substantial remodeling or repairs in order to prepare a residential structure for sale. Perhaps unbeknown to the owner, one of the subcontractors fails to pay a material supplier, who, after the sale of the residential property occurs, records a claim of construction lien for unpaid materials. The purchaser is now in the unenviable position of having to either pay the supplier to discharge the lien or seek to compel the seller to pay or remove the lien. Otherwise, the purchaser is potentially subject to foreclosure by the lien claimant (as well as significant liability under his trust deed for attorney fees if the lender hires its own attorney to defend the lien claim).

The HPA was designed to give the new homeowner in the above-scenario a more effective remedy than simply making an indemnity claim upon the seller or making a claim with the Construction Contractor's Board (if the seller was a licensed contractor). Until December 31, 2010, however, the application of the HPA could be avoided by simply obtaining the purchaser's written waiver of protection under the Act. Anecdotally, this is exactly what most owners did – thereby making the owner's compliance with the HPA a matter of simply requiring the purchasers to sign one more piece of paper (the HPA waiver) at closing.

For "covered" sales completed on or after January 1, 2011, the legislature deleted the "waiver" option. See *Section 1, Chapter 77, Oregon Laws 2010 Special Session*. Instead, the owner now must provide the purchaser a completed "Notice of Compliance with the HPA" at the time of sale that shows the owner is relying upon one of the five protections more specifically described in ORS 87.007(2)(a-e). See ORS 87.007(3). A copy of the Notice of Compliance can be obtained from the Oregon Construction Contractor's Board website at: http://www.oregon.gov/CCB/publications.shtml#Miscellaneous_Publications_and_Information).

The five options from which a covered seller must choose one are as follows:

1. **Title Insurance that does not contain an exception for construction liens.** Often, this type of title insurance is referred to as "early issue" title insurance. A typical title insurance policy excludes coverage for recorded and unrecorded construction liens, and therefore, is not sufficient under the HPA. The removal

of the "lien" exclusion generally requires not only payment of an additional premium, but also the owner often must provide an indemnity to the title company for any liens that are recorded. A title company, however, may not be willing to issue such a policy if the seller does not meet its underwriting requirements, which may include providing adequate security for payment of liens.

2. **Retain 25% of the sale price in escrow with instructions to pay construction liens.** The instructions must provide for payment upon the purchaser's demand of any liens recorded against the property after the date of sale. The funds may not be released until 90 days has passed since the date construction was completed without any liens being recorded, or if a lien is recorded, 135 days has passed since the date of recording and all such lien have been released or waived. Although not explicit, presumably the statute contemplates that permitting the lien to expire by operation of law constitutes a "waiver." See ORS 87.055 regarding the deadline to file an action to foreclose the construction lien.

3. **Maintain a bond or letter of credit for 25% of the sale price.** The Oregon Construction Contractor's Board regulations provide the requirements for the form of bond and the letter of credit. See OAR 812-12-0145 (bonds) and 812-12-0150 (letters of credit). Among the requirement for the letter of credit is that it may be called upon demand of the purchaser if a lien is recorded unless the owner first obtains a written lien release or provides proof of removing the lien by filing a cash deposit or lien release bond pursuant to the procedures under ORS 87.076 to 87.081.

4. **Obtain and provide to the purchaser at closing written waivers received from every person that claims a lien that exceeds $5,000**. Although the HPA is unclear, the Oregon Lien Law contemplates that a person who "claims" a lien need not actually file a construction lien in the real property records until the deadline for doing so. See ORS 87.035(1-2) (distinguishing between "claiming" a lien and "perfecting" a lien by recording the claim of lien in the appropriate form). Accordingly, a homeowner could argue that compliance with this provision requires not only obtaining the written waiver of everyone who *has* filed a lien for $5,000 or more, but everyone who *could* file a lien for $5,000 or more. Obtaining a waiver from every subcontractor and supplier who has mailed the owner a Notice of Right to a Lien pursuant to ORS 87.021 may not, however, be sufficient under particular circumstances. For example, consider a business entity who is the owner of a spec home or condominium. The business entity will never occupy the home or condominium as a residence (as it is an impossible for an artificial entity to do so). Accordingly, a subcontractor or supplier may argue that mailing a Notice of Right to a Lien is not required to record a valid lien against the spec home or condominium based upon the more narrow definition of "residential building" under the notice statute. See ORS 87.021(1) (general requirement to mail notice) and (3)(b) (exclusion from notice requirement for "commercial improvements" and applicable definitions).

5. **Complete the sale after the deadline for perfecting liens pursuant to ORS 87.035.** Depending on the nature of what the lien claimant provided and date of work, a valid lien may be recorded as late as 75 days after completion of construction of the improvement. See ORS 87.035(1) and 87.045. At times, determining when "completion of construction" occurs may be difficult to ascertain or subject to dispute. For example, despite the homeowner moving in and using the home as a residence, the Court in *Farrell v. Lacey*, 264 Or. 505 (1973) permitted a lien to be enforced for new work requested by the homeowner. The lien would have been invalid had the owners' move in

date been considered "completion of construction" under former ORS 87.035. *Farrell*, at 511-512 (installation of a sump pump after the basement flooded extended the time for recording a lien. Former ORS 87.035, recited in n. 1). A seller is well-advised to proceed conservatively when contemplating the use of this provision as proof of compliance with the HPA.

As made clear by the last option of waiting to complete the sale until after the lien recording deadline expires, the temporal coverage of the HPA is not co-extensive with the deadline for recording a valid construction lien. The HPA applies to construction that is "completed" within three months of the sale. A construction lien for labor, materials and rental equipment must be recorded within the earlier of 75 days of the last day of substantial work or completion of construction. ORS 87.035(1). The deadline to record a lien for the services of various design professionals is 75 days from "completion of construction." *Id.* For purposes of recording a construction lien, "completion of construction" often occurs when "the improvement is substantially complete," but may also occur when a completion notice is posted and recorded in compliance with the statute or when the improvement is abandoned (or not abandoned) in accordance with the statute. See ORS 87.045.

What is unclear from the statute's text is whether the HPA's use of the term "completion" for measuring the date from which the three month period of regulation applies is to be determined by the same test as "completion of construction" for a lien claim under ORS 87.045. If so, determining when the three month period from completion of construction commences – as demonstrated by the *Farrell v. Lacey* example – may be subject to some dispute and should itself be determined conservatively.

An owner's failure to comply with the HPA, particularly if a construction lien is recorded, can create significant liability. A violation of the HPA constitutes a Class A violation. More importantly, an HPA violation provides the purchaser with a statutory claim against the seller for twice any actual damages incurred, attorney fees, and possibly an Unlawful Trade Practices Act ("UTPA"). See ORS 646.608(1)(zz).

A claim under the HPA has a two year statute of limitation from the sale, as opposed to a one year statute of limitation from the date of discovering the unlawful practice for UTPA claims. Compare ORS 87.007(6) with ORS 646.638(6). A real estate licensee acting in his or her professional capacity is not liable in any criminal, civil or administrative proceeding that arises from an owner's non-compliance with the HPA. ORS 87.007(4).

The owner may have defenses to HPA and UTPA claims. ORS 87.007(7 & 9) provides various defenses to civil and criminal HPA proceedings. These include proof that the lien is invalid, or obtaining a release of the claim of lien, or showing that the liens are a result of work or supplies provided at the request of the purchaser. Although not explicit, presumably the "release of the lien" defense (subsection 7(b)) includes the owner's use of the procedures under ORS 87.076 to 87.081 to remove the lien from the property by recording a lien release bond or making a cash deposit with the County treasurer for 150% of the lien amount.

Further, there are other carve-outs. If the owner is disputing the lien in a judicial proceeding or through the Construction Contractor's Board, then the owner shall not be deemed in violation of the HPA during the period of the pending dispute. ORS 87.007(8).

In sum, the ease of obtaining a waiver of the purchaser's rights at closing has meant that parties have been able to avoid complexities that have been lurking in the HPA since its passage in 2003. Now that the legislature has removed of this option, many more owners – from sophisticated developer-contractors to small residential owners – may find themselves subject to significant liability in the event post-closing construction liens are recorded.

Construction Law Section
Executive Committee

Darien Loiselle, chair: *dloiselle@schwabe.com*
James Van Dyke, chair-elect:
jvd@ci.portland.or.us
Gary Christensen, past chair:
gary.christensen@millernash.com
Pete Viteznik, Secretary:
pviteznik@kilmerlaw.com
Jason Alexander, Treasurer:
jason@sussmanshank.com

Members at Large:
Fritz Batson: *batson@gleaveslaw.com*
Bill Boyd: *william.j.boyd@state.or.us*
Timothy Dolan:
timothymdolan@oregoncoast.com
Dan Duyck: *dduyck@whippleduyck.com*
Frank Elsasser: *frankelsasser@comcast.net*
Dan Gragg: *gragg@seifer-yeats.com*
Tara Mellom: *tmm@scott-hookland.com*
Bob O'Halloran: *roberto@mcewengisvold.com*
Tom Ped: *tped@williamskastner.com*
Scott Sideras: *scotsid@co.clackamas.or.us*
Tyler Storti: *tstorti@lawssg.com*
Jeremy Vermilyea; *jvermilyea@schwabe.com*

Newsletter Editor:
Alan Mitchell: *alan@mitchell-lawoffice.com*