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RISKS INVOLVED WITH MARIJUANA CONSTRUCTION PROJECTS

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Under Measure 91, recently passed by voters, the sale, possession, and growing of marijuana will soon be legal under Oregon State law. The Act introduces new businesses to the State of Oregon: marijuana cultivation centers and dispensaries. These entities no doubt will retain construction contractors to perform various tasks from time to time. Contractors are urged to take appropriate precautions when dealing with these new businesses, as marijuana remains illegal under the federal Controlled Substances Act, 21 U.S.C. §§ 801-971. Undoubtedly some of our construction industry clients will be asked to construct or renovate facilities used for the sale and growing of marijuana. Our clients may wish to take on that work as marijuana growers and dispensaries have high profit margins and a ready market for their product.

However, engaging in construction activities for marijuana producers and distributors has risks. As mentioned, marijuana remains an illegal controlled substance under Federal law. The main resulting issues are that (1) accepting payment from marijuana business and depositing it into your account could be considered money laundering; and (2) the act of facility construction could be considered conspiracy to manufacture a controlled substance. These charges, depending on the amount of marijuana involved, would trigger five or ten year mandatory sentences under Federal Law.

As a result of the money laundering issues, many marijuana businesses in Washington and Colorado have had to pay their bills in cash. There was one case in Colorado where a contractor had his bank account closed for depositing marijuana business construction funds in their bank account. Although recent federal enforcement guidelines indicate that growers and dispensaries may not be prosecuted if they operate in compliance with state law, the Department of Justice will continue to criminally prosecute these entities–despite state law legalizing their activities–if prosecution serves an important federal interest. Conflicts Between State and Federal Marijuana Laws: Hearing Before the S. Comm. On the Judiciary, 113th Cong. 2-4 (Sept. 10, 2013).

Therefore, raids, property forfeiture, and property seizure remain an ongoing risk for marijuana-related businesses and any party contracting with them. If the property of the grower or dispensary is seized on the basis that it is used for illegal means, any construction lien may be useless. Further, certificates of insurance and bank loans may be harder to obtain while working on projects for marijuana-related businesses. Moreover, federal courts might decline to intervene where legal recourse typically would be permitted on the basis that entities dealing with marijuana and marijuana-related entities have “unclean hands,” given that the sale and possession of marijuana remains a serious federal crime. See, *e.g.*, *Northbay Wellness Group, Inc. v. Beyries*, No. C 11-06255, 2012 U.S. Dist. LEXIS 133377, at *8 (N.D. Cal. Sept. 18, 2012).

In sum, the Justice Department is not currently pursuing federal charges against businesses selling or growing marijuana legally under state law. But that guidance expressly states that the policy is subject to change at any time, and there is no guarantee that this administration, or any subsequent one, will continue that policy. Make sure you let your clients know the risks.

A "DISCOVERY" RULE FOR BREACH OF CONTRACT CLAIMS?

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Recent decisions from the Oregon Court of Appeals have disrupted conventional wisdom about the statute of limitations applicable to breach of contract claims. Since 2008, when the Court of Appeals issued *Waxman v. Waxman and Assoc.*, 224 Or App 499 (2008), many thought that Oregon's statute of limitations for contract claims, ORS 12.080(1) ran from the date of the alleged breach of contract. That statute provides for a six year limitation period. So in a construction contract, if a subcontractor failed to perform its work in a timely manner as promised in its contract, costing the general contractor, owner or others money, then those parties would have six years to sue to recover the money (unless a shorter period or some other alternative dispute resolution process was agreed in the contract). It would be irrelevant when the general contractor realized (or discovered) that it had lost money because of the breach; it would only matter when the breach itself occurred.

However, based on more recent case law, parties are arguing, and judges are holding, that the breach itself is not dispositive anymore; it is when the damages from that breach were discovered and the "breach of contract" claim itself *accrued*. For example, former Supreme Court Justice and Judge *Pro Tem* Robert D. Durham recently ruled as follows in a Multnomah County Circuit Court action: "Should the Court of Appeals face this issue in an appropriate case in the future, it is clear that that court would conclude that the period of limitations for a contract claim is governed by a discovery rule." *Specialized Housing VII v. Seabold Construction Co., Inc., et al.*, Multnomah County Case No. 1310-14787 (Letter Op. February 17, 2015). This follows similar holdings in Washington County. *See Kilada v. Arbor Roses, LLC*, Washington County Case No. C121803CV (July 25, 2014), and *Eagle Ridge Townhomes Owners' Ass'n v. Apollo Custom Homes*, *Inc.* Washington County Case No. C124431CV (July 15, 2014). How did we get here? The answer is ORS 12.010 operating on ORS 12.080.

In 2014, the Court of Appeals decided *Rice v. Rabb*, 354 Or 721 (2014). The facts of this case are fairly notorious: Joan Rice had inherited rightful legal claim to the "Queen Outfit," of the "1930 Queen of the Pendleton Round-up." The "Queen Outfit" had been donated to the Pendleton Round-up and Happy Canyon Hall of Fame for display, but when someone removed the "Queen Outfit" from its display in 2000, Ms. Rice did not realize this until 2007. Upon this discovery, she sued for conversion and replevin.

The Court reviewed the applicable statute of limitation at ORS 12.080(4), which provides only that the claims "shall be commenced within six years." ORS 12.080. Well, within six years of what? To answer that, we must look to ORS 12.010. That statute provides that, "Actions shall only be commenced within the periods prescribed in this chapter, after the cause of action shall have accrued, except where a different limitation is prescribed in the statute." So the Court in *Rice* focused on the question: when does a claim accrue?

The *Rice* court found its answer in *Berry v. Branner*, 245 Or 307 (1966):

> It accrues whenever one person may sue another. The cause of action must necessarily accrue to some person or legal entity. To say that a cause of action accrues to a person when she may

> maintain an action thereon and, at the same time, that it accrues before she has or can reasonably be expected to have knowledge of any wrong inflicted upon her is patently inconsistent and unrealistic.

Rice, 354 Or 727-8 (quoting *Berry v. Branner*, 245 Or 307, 311-2 (1966)). From there the Court quickly reasoned that, since ORS 12.010 applies to the whole chapter, including ORS 12.080, then the clock started when the claims accrued, and that the claims accrued when they were discovered. *Id*. at 731.

Since *Rice*, there have been a number of rulings on this issue. In early October 2014, the Court of Appeals released *Tavtigian-Coburn v. All Star Custom Homes, LLC*, 266 Or App 220 (2014), in which the Court relied on *Rice* to hold that a discovery rule applied to claims for negligence and nuisance under ORS 12.080(3). Then, at the end of October, the Court of Appeals decided *Riverview Condominium Ass'n v. Cypress Venture, Inc.*, 266 Or App 574 (2014) There, the Court again relied on *Rice* to hold that a discovery rule applied to claims for nuisance under ORS 12.080(3). Finally, in December 2014, the Court of Appeals decided *Goodwin v. Kingsmen Plastering, Inc.*, 267 Or App 506 (2014), again affirming that claims "accrue" under ORS 12.010 when the claims are discovered.

It will be interesting to see what the Court of Appeals or Supreme Court does when squarely presented with the issue of ruling whether a discovery rule applies to breach of contract claims, as governed by ORS 12.010. In *Waxman*, the Court of Appeals took a "claims based" approach, analyzing the type of claim at issue and referring to case law holding that, for breach of contract claims, the claims accrue on breach. But starting with *Rice*, the Supreme Court and subsequent Court of Appeals decisions have pointed toward a "statute based" approach, in which it quite simply makes no sense to say that a claim "accrued," and possibly expired, all while the holder of the claim had no knowledge of it. This essentially defines a discovery rule into the concept of accrual in ORS 12.010.

In the meantime, construction contractors and their lawyers can rely on the 10-year statute of repose in ORS 12.135 when assessing risk duration and liability. More proactively, parties are able to adjust the applicable statutes of limitation applicable to their disputes within the text of their contracts. This may be clearest when it comes to contract rights and obligations, and the remedies applicable to a claim for breach of contract. Parties should make sure that their rights and responsibilities are clearly set out and agreed upon in the contract if they want to clarify or limit the statute of limitations applicable to claims for breach of contract.

RESTRICTIVE COVENANTS: CREATION, CONFLICT, AND ENFORCEMENT

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Restrictive covenants arise in land partitions, mineral leases, real property conveyances and, of course, land subdivisions. They are created through contracts, plats, leases and deeds. A recurring issue is whether the restriction "runs with the land" and is binding on successors-in-interest. Some case examples follow:

1. Successor to grantor of logging-road easement sought to prevent grantee's successor from using the road. Court found that the unambiguous language trumped over ambiguous intent, therefore the easement terminated after grantee no longer owned the land. *Hunnell v. Roseburg Resources Co.*, 183 Or App 288, 51 P3d 680 (2002).

2. Plaintiffs' predecessors sold partitioned land to defendants but retained the remainder. Simultaneously with the sale, the parties signed an agreement, which

contained a covenant restricting development and construction on the remaining land. The burdened land was legally described in the agreement which was recorded. The Supreme Court held that plaintiffs were bound by the covenant entered into by their predecessors. Specifically, the court found that the recording of the agreement provided constructive notice, and that the use of the word "assigns" was sufficient to establish intent that the covenant run with the land. *Huff v. Duncan*, 263 Or 408, 502 P2d 584 (1972)

3. Plaintiff was a tenant evicted from her property by defendants. The original developers of the property were the recipients of over $2 million in Low Income Housing Tax Credits (LIHTC) through a program with the Oregon Housing and Community Services Department (Department). In order to receive the tax credits, the original owner of the project entered into an agreement with the Department which required that it would maintain 100 percent of the project as low income housing for thirty years and that, as a condition precedent to the issuance of the tax credits, it would record restrictive covenants that included the restrictions contained in the agreement. Subsequent owners of the property evicted plaintiff in violation of the covenants. *Nordbye v. BRCP/GM Ellington*, 246 Or App 209, 266 P3d 92 (2011).

4. A property owner brings an action to enjoin construction of houses that are in violation of density restrictions that apply to the lots in the subdivision. The fact that the neighboring property owners did not act to enforce their rights until a year and a half after the builder first filed for ARC approval did not waive their ability to enforce. *Swaggerty v. Petersen*, 280 Or 739, 572 P2d 1309 (1977).

5. Contractor builds home that obstructs neighbor's view in violation of restrictive covenant. Neighbor sues contractor for negligence. Contractor tenders to its insurance company but company will not cover because the obstructed view is not "tangible property damages." *Mitchell, Best & Visnic, Inc. v. Travelers Property Cas. Corp.*, 121 F Supp 2d 848 (D. MD. 2000).

Oregon should follow the modern trend and adopted Restatement (Third) Property: Servitudes because Oregon restrictive covenants law is unduly complicated. Both Oregon law and Restatement are discussed below.

Under current Oregon law, for a restrictive covenant to run with the land and bind successors-in-interest, the following four requirements must be met:

(1) There must be privity of the estate between the promisor and his/her successor;

(2) The promisor and promisee must intend that the covenant run with the land;

(3) The covenant must touch and concern the land of the promisor; and

(4) The promisee must benefit in the use of some land possessed by him as a result of the performance of the promise.

Nordbye v. BRCP/GM Ellington, 246 Or App 209, 225, 266 P3d 92 (2011).

1. <u>Privity</u>

Privity arises out of a transfer of an interest in land benefited by the promise. *Huff v. Duncan*, 263 Or 408, 411, 502 P2d 584 (1972), citing 5 *Restatement, Property (Servitudes)*, § 534 (1944). Traditionally, privity of estate is satisfied when a party shows both vertical and horizontal privity. *See*, 9 *Powell on Real Property* § 60.04(3)(c)(v) (Michael Allan Wolf ed 2001 and Supp 2013). Horizontal privity requires that a covenant is created as part of simultaneous conveyance of an estate between the original parties. 20 *Am Jur 2d Covenants, Conditions and Restrictions* § 26 (2014). For example, horizontal privity exists when a covenant is created in a deed conveying the property from one party to another. Vertical privity refers to the relationship between a covenanting party and its successor in interest. Vertical privity exists when the successor owns the same estate as the original party to the covenant, in at least some of the land.

The modern trend, however, which is set out in the *Restatement (Third) of Property: Servitudes* (2000) (hereinafter "*Restatement (Third)*"), rejects both horizontal and vertical privity (concepts that are arcane and difficult to understand). *See, Restatement (Third)*, § 2.4, comment b; § 5.2, comment b*; Lake Limerick Country Club v. Hunt Mfg. Homes, Inc*., 84 P3d 299 (2004) (noting and accepting that horizontal privity is not required under *Restatement (Third)* analysis); *Winn-Dixie Stores, Inc. v. Dolgencorp, LLC*, 746 F3d 1008, 1032 (11th Cir 2014) (vertical privity is not required under modern trend reflected by *Restatement (Third)).*

Oregon has not yet adhered to this modern trend in case law. However, Oregon Court of Appeals has found enforceable equitable servitudes where the privity requirements are not met. *See e.g. Fitzstephens v. Watson*, 218 Or 185, 207, 344 P2d 221 (1959).

2. <u>Intent</u>

Intent for a covenant to run with the land can be established by the inclusion of the language stating that heirs, successors and assigns of the promisor are to be bound and heirs successors and assigns of the promisee are to benefit. But, all three words, "heirs, successors and assigns" are not necessary, although best included to avoid dispute. *Huff v. Duncan*, 263 Or 408, 411, 502 P2d 584 (1972).

Intent can be established by recording the agreement or a memorandum of the agreement. *See, Gorger v. Gorger*, 276 Or 267, 555 P2d 1 (1976) (recording of a lease indicated intent). Intent can also be implied under certain circumstances. *See, e.g. Hohman v. Bartel*, 125 Or App 306, 312, 865 P2d 1301 (1993), *adh'd to as modified on recons*, 128 Or App 384, 876 P2d 347, *rev den*, 320 Or 110 (1994) (finding implied intent to restrict property to one house per lot); *Hudspeth v. Eastern Oregon Land Co*., 247 Or 372, 379, 430 P2d 353 (1967) (Intent "may be derived from the language used in the instrument or from the fact that the undertaking is one which because of business practice, custom, or the common understanding of the community is deemed to have been intended to benefit those who succeed to the promisee's land.").

The *Restatement (Third)* also provides for implied intent in creation of a servitude or covenant. *Restatement (Third)* § 2.1 states "the intent to create a servitude may be express or implied. No particular form of expression is required."

3. <u>Touches and Concerns the Land</u>

The Oregon Supreme Court explains that covenants running with the land "…have for their object something annexed to or inherent in or connected with the land…" *Texas Co. v. Butler*, 198 Or 368, 374, 256 P2d 259 (1953) (lessee sued vendor's successor in title to enforce option to purchase). The benefit does not have to be physical. Covenants to pay maintenance costs for common property have generally been upheld to satisfy the touch and concern requirement. See, e.g., *Bessemer v. Gersten*, 381 So2d 1344 (Fla 1980) (covenant to pay maintenance for common use facilities runs with the land; lien to enforce covenant supersedes homestead exemption); *Lincolnshire Civic Ass'n., Inc. v. Beach*, 46 A2d 596, 364 NYS2d 248 (1975) (covenant to belong to an association that assesses its members for maintenance of recreation areas runs with the land). However, in *Ebbe v. Senior Estates Golf and Country Club*, 61 Or App 398, 657 P2d 696 (1983), the Oregon Court of Appeals found that where a subsequent property owner had not joined the adjacent country club, there was no common property benefiting the subsequent owner, so the covenant to pay fees did not "touch and concern" the land of the owner and was therefore not binding on the subsequent owner.

The *Restatement (Third)* eliminates the "touch and concern" requirement altogether. *Restatement (Third)*, § 3.2.

4. Benefits/Consideration

As with all binding contracts, in order for a restrictive covenant to run with the land, there must be a benefit or consideration to the promisee. Restrictive Covenants and Servitudes under the *Restatement (Third) of Property: Servitudes (2000)*

Oregon law currently recognizes "real covenants" and "equitable servitudes" as distinct devices impacting property. *The Restatement (Third)* eliminates the terms "real covenant" and "equitable servitude" and instead uses the word "servitude." *Restatement (Third),* § 1.4. Under the *Restatement (Third)* "servitude" is a generic term that describes legal devices that private parties can use to create rights and obligations that run with the land. *Id.,* § 1.1, comment (a). The term servitude covers easements, profits, and covenants that run with the land. *Id.,* § 1.1, cmt. (d). The Introductory Note to the *Restatement (Third)* explains:

> "[T]he differences between covenants that historically could be enforced at law and those enforceable in equity have all but disappeared in modern law. Continuing use of the dual terminology of real covenant and equitable servitude is confusing because it suggests the continued existence of two separate servitude categories with important differences. In fact, however, in modern law there are no significant differences. Valid covenants, like other contracts and property interests, can be enforced and protected by both legal and equitable remedies as appropriate, without regard to the form of the transaction that created the servitude."

Restatement (Third), Introductory Note at 7-8.

As discussed above, the *Restatement (Third)* approach reduces the elements stated in *Nordbye* for a binding covenant or servitude to two requirements: 1) the parties intended to create the servitude; and 2) they used appropriate formality, complying with the Statute of Frauds and other state law requirements for contracts and transfers of interests in land. *Restatement (Third)* § 2.1(1) (a). Under the *Restatement (Third)* approach, the burdens and benefits of servitudes are addressed directly, and the rules of succession are formulated to meet the expectations [intent] of the parties to the covenant and their successors. *Id.* In two servitude cases, the Oregon Court of Appeals applied the *Restatement (Third)* but those cases pre-dated *Nordbye,* which is still good law. *See Johnson v. Cornelius*, 230 Or App 733, 218 P3d 129 (2009); *Mountain High Homeowners Ass'n. v. J.L. Ward*, 228 Or App 424, 209 P3d 347 (2009).

The *Restatement (Third)* methodology to determine whether a binding "servitude" (real covenant or equitable servitude) exists reflects the modern view that embodies a straightforward and streamlined analysis. Whether it is ultimately adopted by the Oregon court remains to be seen but in the meantime, *Nordbye* is controlling as to creation and enforcement of restrictive covenants.

THE APPELLATE COURT'S LITTLE MILLER ACT REFRESHER

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The Oregon Court of Appeals recently issued an opinion in the case *KT Contracting Co., Inc. v. Ross Bros. & Co., Inc.*, 268 Or App 438 (2015), which serves as a general refresher on Oregon's Little Miller Act.

In 2003, Ross Bros. & Co., Inc. ("Ross"), as general contractor, hired KT Contracting Co., Inc. ("KT"), as a subcontractor to provide labor and materials for traffic control on an ODOT bridge renovation project. The project ran into significant delays, and KT submitted a claim to Ross for over $80,000 for extended equipment rental.

When Ross refused to pay KT relative to its claim and for other unpaid work on the Project, KT filed suit against Ross including a Little Miller Act bond claim in the amount of $245,134 also naming Ross' surety, Safeco Insurance Company of America ("Safeco"). In response, Ross and Safeco asserted counterclaims in the amount of $288,000 for liquidated damages. KT ultimately filed a second amended complaint alleging three bond claims against Ross and Safeco, three breach of contract claims against Ross and, in the alternative, a *quantum meruit* against Ross.

The trial court later ruled that KT was entitled to recover on its *quantum meruit* claim against Ross. KT submitted a proposed form of judgment naming both Ross and Safeco as judgment debtors; however, the general judgment entered by the trial court only named Ross as judgment debtor. KT appealed the trial court's decision, arguing that Safeco should also be a named judgment debtor based on its Little Miller Act claim.

The Court of Appeals ultimately found in KT's favor, confirming that the trial court should have also named Safeco as a judgment debtor based on KT's asserted Little Miller Act claim. Although the trial court did not explain its reasoning for excluding Safeco from the subject judgment, the Court of Appeals inferred that Safeco was excluded because KT did not explicitly name Safeco as a defendant in its prevailing *quantum meruit* claim.

The Court of Appeals explained that a payment bond under the Little Miller Act makes the surety primarily liable for payment of the contractor's debt to a claimant who has supplied labor or materials for performance of work. Thus, the whole point of the Little Miller Act is to "protect suppliers of materials and labor for a public works project by providing them with an alternative source of payment." Specifically, Oregon's Little Miller Act requires a prime contractor on a public improvement contract to secure a payment bond for the protection of claimants. ORS 279C.380(1)(b). A claimant has a right of action on that payment bond if the claimant: 1) supplied labor or materials for performance of the work provided for in a public contract; 2) had not been paid in full for the labor or materials provided; and 3) had given written notice of claim to the contractor and the contracting agency. ORS 279C.600(1).

In this case, KT properly pleaded its bond claim and met each of the subject requirements: 1) it supplied labor and materials for the performance of work on an ODOT project; 2) Ross had not paid KT in full for the labor and materials provided; and 3) KT gave written notice of its claim to both Ross and ODOT. Having met the Little Miller Act's requirements, the fact that KT won its case on the theory of *quantum meruit* (as opposed to breach of contract) did not preclude Safeco from liability. In fact, the Court expressly noted that permitting sureties to escape liability because a claimant won under one theory of law and not another would undermine the whole purpose of the Little Miller Act.

This recent ruling is a helpful reminder that Little Miller Act claims are not merely stand-alone claims. Rather, claimants must plead and prove their underlying claims of entitlement. Once entitlement is established, the surety (who has expressly assumed liability for the principal's debt) will be liable irrespective of legal theory as long as the elements of the Little Miller Act claim are also established. The Court's ruling reminds us that the purpose of the Little Miller Act is to make the claimant whole, and there is no claim specific hurdle to recovery found in ORS Chapter 279C.

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