Oregon State Bar Construction Law Section

# Construction Law Newsletter

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## LENDERS' TITLE INSURANCE COVERAGE AND CONSTRUCTION LIENS

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Construction liens (also known as mechanics' liens) may pose a worrisome risk to lenders providing loans for construction projects. Properly perfected construction liens take priority over prior recorded liens, mortgages and encumbrances on the land on which the improvement is being constructed. ORS 87.025. The "broken priority" then held by a loan can be problematic for lenders on construction projects in a way that may or may not be able to be solved by title insurance.

Alysha Van Zante

**Construction Liens in Oregon**

In Oregon, construction liens are a purely statutory remedy governed by ORS 87.001 to 87.093. Several categories of people involved in a construction project may claim a right to a construction lien, including by not limited to: prime contractors, subcontractors, persons performing labor, persons transporting or furnishing materials, architects, landscape architects, land surveyors and registered engineers. ORS 87.010. Given this broad array of players entitled to construction liens, and the amount of money usually involved, the risk of a lien being filed is significant.

Although the rule "first in time, first in right" usually governs lien priority, the statutory exception in ORS 87.025(2) grants super-priority to construction liens, and allows them to jump ahead of prior recorded liens, mortgages or encumbrances. However, the statutory window to perfect (by filing a claim of lien with the recorder's office) a construction lien closes 75 days after completion of construction. ORS 87.035(1). Unperfected construction (sometimes called "inchoate") liens lie silently in wait during this window of time.

In the past decade or so, title insurers have gained an unfortunately intimate understanding of the risks that super-priority construction liens pose. This risk came into focus as the 2008 mortgage crisis rocked the markets. As the housing market crashed, unfinished construction projects led to an influx of construction liens with super-priority, while cash flows were running dry at the same time. As a result, title insurers seem to have reevaluated coverage for construction liens.

**Title Insurance Coverage for Construction Liens**

Title insurance, like most other forms of insurance, is a heavily regulated industry. Oregon title insurers and their agents are regulated by the Oregon Insurance Commissioner pursuant to the Oregon Insurance Code (ORS Chapters 731 to 750). DEAN P. GISVOLD & JONATHAN M. RADMACHER, 1 OREGON REAL ESTATE DESKBOOK, Chapter 7, *Title Insurance* § 7.2-1 (OSB Legal Pubs 2015 ed.). The Oregon Insurance Division is part of the Oregon Department of Consumer and Business Services, and the director of that department serves as the Insurance Commissioner. *Id.*

In Oregon, the forms, policies and rates charged by insurers are reviewed and proposed by the Oregon Title Insurance Rating Organization (OTIRO). *Id*. at §7.2-3 (citing ORS 742.003, ORS 737.205—737.560). The forms, policies and rates must be approved by the Oregon Insurance Commissioner. *Id*. All of the title insurance companies doing business in Oregon are members of OTIRO; therefore, there is no variation in the policy and endorsement forms used, or the rates charged by title insurers in Oregon. *Id*.

Standard title insurance coverage can be paired with selected endorsements, which add to or limit title insurance coverage. Endorsements allow policy purchasers to tailor coverage to their specific circumstances. OTIRO has approved endorsements that serve as a menu for lenders, or their lawyers, to select from. In Oregon, over 100 endorsements have been adopted for use. *Oregon Rating Manual*, OREGON TITLE INSURANCE RATING ORGANIZATION, https://oregonlandtitle.com/files/otiroratemanual.pdf.

The standard title insurance coverage offered will not insure a lender against losses incurred by construction liens. GISVOLD, *supra* at § 7.5-11. The majority of title insurers have been hesitant to provide lenders with any type of extended coverage, which would insure the lender from losses incurred from construction liens prior to the expiration of the 75-day statutory lien period. *Id*.

Katie Jo Johnson

However, two endorsements specific to construction lien coverage are currently offered in Oregon: the OTIRO End. 232-06 (ALTA 32-06) and the OTIRO End. 233-06 (ALTA 33-06). *See also* OTIRO End. 232.1-06 and OTIRO End.

232.2-06. Although not "early issue" coverage, as the general construction lien exception will remain until the expiration of the lien period, these endorsements have the advantage of bringing construction lien coverage forward with each OTIRO 233-06 date-down endorsement. But the endorsements come at a price: The OTIRO 232-06 endorsement costs $1.00 per $1,000, based on the loan amount, with a minimum charge of $250. *Oregon Rating Manual*, *supra* at 10-19.The OTIRO 233-06 costs $250 per endorsement. *Id.* To illustrate, on a $5 million loan, the OTIRO 232-06 endorsement alone would cost $5,000.

Other states seem to offer better or cheaper coverage options. For example, in Washington, the same construction lien endorsements are being offered at cheaper prices or even free. Oregon's higher prices may be diminishing lenders' desire to lend in Oregon. And of those lenders who do decide to lend in our state, some may decide to forgo traditional title insurance coverage for construction liens and instead pursue cheaper approaches.

**Title Insurance Alternatives**

Lenders and their lawyers have come up with several alternatives to obtaining "early issue" coverage for construction liens. One preferred alternative is to purchase the OTIRO End. 70, which provides a package of date-down endorsements specific to construction liens. A package of ten date-downs costs 5% of the Basic Insurance Rate, with a minimum charge of $200, and a maximum charge of $1,000. *Oregon Rating Manual*, *supra* at 10-5. Before the construction lender decides to advance additional funds, the endorsement will be used to show any construction liens that were recorded prior to the date of the date-down. When construction is completed and the 75-day statutory period has passed, the title insurer will eliminate the coverage exception for construction liens (Standard Exception 5) with a pre-paid endorsement to do so (OTIRO End. 66).

The lender/insurer may require or may also require an affidavit from the owner of the property which provides sufficient evidence that construction liens will not be filed (i.e. all work completed has been paid in full). GISVOLD, *supra* at § 7.5-11. The lender/insurer could also instead require satisfactory indemnities from the owner that insure against losses incurred by construction liens, although there is an open question regarding the sufficiency of indemnities. *Id.*

**Conclusion**

While title insurance coverage is a necessity for lenders funding construction projects, attorneys working with lenders should advise their clients about options to obtain coverage for construction liens. Oregon's higher-priced endorsements may require some creative solutions.

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## CGL COVERAGE: DAMAGE TO CONTRACTOR'S OWN WORK

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Commercial General Liability ("CGL") insurance covers a contractor's liability because of property damage "to which this insurance applies." Gone are the days that a CGL carrier might argue that physical injury to the contractor's own work is not property damage in the first instance. *See FountainCourt Homeowners' Ass'n v. FountainCourt Dev., LLC*, 264 Or. App. 468, 483–84 (2014), *aff'd*, 360 Or. 341 (2016) ("We reject the idea that the 'your work' distinction is * * * one inherent in the definition of 'property damage,' rather than an exclusion under the policy."). Now, when an insured contractor has damaged its own work, CGL carriers usually skip straight to: (1) the j(5) and j(6) exclusions, and (2) the "your work" exclusion. Importantly, these exclusions often do not apply to the facts of a particular case, even where the insured's own work is damaged.

The j(5) exclusion applies to property damage to "[t]hat particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf ***are*** performing operations, if the 'property damage' arises out of those operations." (Emphasis added.)

The j(6) exclusion applies to property damage to "[t]hat particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it." However, the j(6) exclusion expressly "does not apply to 'property damage' included in the 'products-completed operations hazard,'" which is a defined policy term and generally understood to refer to property damage occurring after completion.

Emily Miller

The "your work" exclusion applies to property damage "to 'your work" arising out of it or any part of it and included in the 'products completed operations hazard.'" However, "this exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor."

As a preliminary matter, the j(5)/j(6) exclusions and the "your work" exclusion are mutually exclusive and cannot all apply to the same property damage. The j(5) and j(6) exclusion do not apply to damage occurring after completion. The j(5) exclusion's use of the phrase "are performing operations" demands this interpretation. *E.g.*, *Glob. Modular, Inc. v. Kadena Pac., Inc.*, 15 Cal.App.5th 127, 137, 222 Cal.Rptr.3d 819 (2017) ("We conclude the use of the active, present tense construction 'are performing operations' indicates the exclusion applies only to damage caused during physical construction activities."). The j(6) exclusion states it outright (precluding its own application where the property damage falls within the "products-completed operations hazard"). Conversely, the "your work" exclusion expressly states that it ***only*** applies to property damage occurring within the "products-completed operations hazard, i.e., after completion.

Identifying whether the property damage at issue occurred before or after completion is, therefore, critical. If the property damage is progressive and falls partially in both camps, identifying which portions fall into which camp is necessary.

For property damage occurring before completion, the j(5) and j(6) exclusions only apply to "that particular part" of property on which work is being performed or that must be restored, repaired or replaced because work was incorrectly performed on it. The coverage dispute often centers on what comprises "that particular part." Insureds argue for a narrow interpretation. *See Bighorn Logging Corp. v. Truck Ins. Exch.*, 295 Or.App. 819, 437 P.3d 287 (2019) (finding the phrase ambiguous and enforcing the insured's narrow interpretation in favor of coverage). For example, by way of a hypothetical, if a contractor were installing beams, and after installing four beams, it negligently handled the fifth beam during its installation, causing damage to all five beams, a narrow construction of "that particular part" would only capture the fifth beam and the CGL policy would nonetheless cover liability because of property damage to the first four installed beams. *See* INSURANCE COVERAGE OF CONSTRUCTION DISPUTES (2d ed.) § 29:7 (providing support for such narrow interpretation). By contrast, carriers argue for a broad interpretation of "that particular part," such that it is essentially coextensive with the project itself. *See Ohio Cas. Ins. Co. v. Ferrell Developments, LLC*, No. 3:10-CV-162-AC, 2011 WL 5358620, at *9-11 (D. Or. July 27, 2011), *report and recommendation adopted*, No. 03:10-CV-162-AC, 2011 WL 5358592 (D. Or. Nov. 7, 2011) (holding that coverage was excluded on the unique facts at issue under either a broad or narrow interpretation).

For property damage occurring after completion, the "your work" exclusion can be problematic for general contractors because "your work" is defined to include all work done by or on behalf of the insured. In the case of new construction, the entire project is the general contractor's "your work." However, the exclusion does not apply by its plain terms if any part of the work at issue was subcontracted. Where a general contractor subcontracted all work, the exclusion clearly does not apply. Even where a general contractor self-performed some work, however, the exclusion still may not apply if, for example: (1) the general contractor's self-performed work damaged subcontracted work, or (2) the general contractor's self-performed work is damaged by subcontracted work.

The take-away is that damage to the insured's work does not automatically foreclose coverage. Rather, it calls for an analysis of exclusions, such as the j(5), j(6), and "your work" exclusions, as applied to the facts of a particular case.

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## RECEIVERSHIP IS THE NEW BANKRUPTCY

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Receivership is becoming the new bankruptcy. In 2017, the Oregon legislature enacted ORS Chapter 37, *et. seq.*, the Oregon receivership act ("the Oregon Act"). While the Oregon Act is based on the bankruptcy code and the uniform receivership act, it does not mirror either. One key difference of the Oregon Act is related to the recording of construction liens.

Upon the filing of a bankruptcy action, 11 USC §362(a)(4) prohibits "any act to create, perfect, or enforce any lien against property of the estate." 11 USC §362(b) provides exemptions to the stay created by §362(a). Specifically, 11 USC §362(b)(3) exempts

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"any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title." 11 USC §546(b) subjects the bankruptcy trustee's rights and powers to generally applicable laws that permit "perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection... ."

A claimant's right to a construction lien under ORS 87.010(1) is created upon the commencement of the improvement. ORS 87.025(7) ("The perfection of a lien under ORS 87.035 relates to the date of commencement of the improvement as defined in ORS 87.005."). ORS 87.005(1) defines "commencement of the improvement" as "the first actual preparation or construction upon the site or the first delivery to the site of materials of such substantial character as to notify interested persons that preparation or construction upon the site has begun or is about to begin." A lien created under ORS 87.010(1) is *perfected* when it is recorded in the real property records. ORS 87.035(2), emphasis added ("A lien created under ORS 87.010 shall be perfected by filing a claim of lien with the recording officer of the county.")

Thus, the prevailing wisdom is that, under the bankruptcy code, a lien claimant does not need to obtain relief from the bankruptcy stay to record a construction lien (the rights to which arose prior to the stay) against the debtor's real property. *See In re Construction Supervision Services, Inc.*, 753 F.3d 124 (2014) & *Matter of Yobe Elec., Inc.*, 30 B.R. 114 (1983). Of course, to take any further action regarding the lien, *e.g.* foreclose the lien, you need to obtain relief from the bankruptcy stay. Unfortunately, under Oregon Act, whether a construction lien claimant needs to obtain relief from the receivership stay to record a lien is less clear.

Similar to 11 USC §362(a)(4), ORS 37.220(1) prohibits any action to enforce a claim against property of the receivership estate. Also like the bankruptcy code, ORS 37.220(5) provides a list of exemptions to the stay mandated by ORS 37.220(1). One of these exceptions is ORS 37.220(5)(d), which mentions ORS Chapter 87. ORS 37.220(5)(d) provides, "[a]ny act to perfect, or to maintain or continue the perfection of, an interest in estate property if the interest perfected would be effective against a creditor of the owner holding at the time of the entry of the order of appointment either a perfected nonpurchase money security interest under ORS chapter 79 against the property, or a lien by attachment, levy or the like, including liens under ORS chapter 87, whether or not such a creditor exists, except that if perfection of an interest would require seizure of the property involved or the commencement of an action, the perfection may and must instead be accomplished by filing and serving on the receiver notice of the interest within the time fixed by law for seizure or commencement * * *." As you can see, the aforementioned statute differs from the language of 11 USC §362(b)(3) and there is no reference to a statute similar to 11 USC §546(b).

As with the bankruptcy code, if the claimant performed work prior to entry of the receivership order, the claimant's rights against the property of the receivership estate arose prior to the entry of the order appointing the receiver. A good argument exists that, regardless of when the claimant's work was performed, if any work was performed prior to the receivership order, the claimant's interest in the receivership property arose prior to the entry of the order. The recording of a lien would seem to constitute an act "to perfect, or to maintain or continue the perfection of, an interest in estate property."

However, unlike the bankruptcy code, ORS 37.220(5(d) does not compare the lien claimant's rights against those of the receiver. The Oregon Act considers whether the construction lien "would be effective against **a creditor of the owner** holding at the time of the entry of the order of appointment either a **perfected nonpurchase money security interest** under ORS chapter 79 against the property, or **a lien by attachment, levy or the like**, including liens under ORS chapter 87." ORS 37.220(5)(d) (Emphasis added). This language does not really square with a construction lien claim. Indeed, an argument exists that ORS 37.220(5)(d) does not apply to a construction lien at all; it was intended to deal with personal property of the estate, not its real property. Assuming ORS 37.220(5)(d) does apply to construction liens, it results in a more complicated analysis, *e.g.* what happens regarding claims by co-lien claimants, a competing claim for a property tax lien, or a claim by a material supplier that did not give a required pre-lien notice? Unfortunately, the Uniform Commercial Real Estate Receivership Act provides no guidance because its language is broader and more similar to the bankruptcy code. Its exemption covers "an act, action or proceeding to perfect, or maintain or continue the perfection of, an interest in receivership property."

It is unclear why the language of ORS 37.220(5(d) differs from the language of Uniform Commercial Real Estate Receivership Act and 11 USC §362(b). Unfortunately, absent a clarifying amendment ORS 37.220(5)(d), there is no clear answer regarding whether a construction lien claimant must obtain relief from the receivership stay to record a construction lien. Therefore, to avoid a potential violation of the receivership stay and motion to declare its lien invalid, a prudent construction lien claimant should petition the court for relief from the stay prior to recording its lien. If the lien claimant is not aware a stay existed at the time it recorded its lien, upon learning of the stay, the lien claimant should immediately seek the entry of an order granting it *nunc pro tunc* relief from the stay to allow the recording of the lien.

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## Steps Construction Attorneys take to Assist Their Construction Clients in Addressing the Impact of the Coronavirus on Current and Future Construction Projects

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By now, just about every construction attorney has received a call from a contractor or owner client about the impact of the ongoing COVID-19 pandemic. This pandemic represents an unprecedented challenge to the construction industry, not just the immediate impact of labor and supply shortages and adapting to social distancing guidelines, but also the long term impact on productivity and supply chain disruption. As construction attorneys, we can assist our clients by reaching out and proactively taking the following steps:

1. <u>Review your clients' respective contracts</u>.

Downstream, upstream, and financing agreements likely contain provisions addressing the risk of this unprecedented challenge. While legal doctrines fill in the gaps, express contract provisions allocating risk will control.

Jacob A. Zahniser

The one term we have all been hearing a lot about is force majeure. You may recall from law school that a force majeure excuses nonperformance of a contract when such nonperformance is caused by unforeseen events beyond the control of either party that makes performance impracticable or frustrates the purpose of such performance.

The AIA suite of contracts typically contain force majeure clause. For example:

> § 8.3.1 If the Contractor is delayed at any time in the commencement or progress of the Work by (1) an act or neglect of the Owner or Architect, of an employee of either, or of a Separate Contractor; (2) by changes ordered in the Work; (3) by labor disputes, fire, unusual delay in deliveries, unavoidable casualties, adverse weather conditions documented in accordance with Section 15.1.6.2, or other causes beyond the Contractor's control; (4) by delay authorized by the Owner pending mediation and binding dispute resolution; or (5) by other causes that the Contractor asserts, and the Architect determines, justify delay, then the Contract Time shall be extended for such reasonable time as the Architect may determine.

ConsensusDocs also typically contain a force majeure clause. For example:

> § 6.3.1 If the Constructor is delayed at any time in the commencement or progress of the Work by any cause beyond the control of the Constructor, the Constructor shall be entitled to an equitable extension of the Contract Time. Examples of causes beyond the control of the Constructor include, but are not limited to, the following: * * * (j) epidemics; (k) adverse government actions * * *.

Unless modified by the parties, these typical force majeure clauses may give the contractor a way to seek an extension of time in light of the pandemic.

Other equally relevant provisions are change-in-law provisions, delays/change order provisions, suspension and termination provisions. All of these may come into play based on the current pandemic. This is certainly not an exhaustive list of potentially relevant contract terms. Every contract is different. The point remains: the first step is assist your client to identify the relevant contract provisions to determine what protections are available under the contract in response to the COVID-19 outbreak.

2. <u>Check potentially applicable common law doctrines</u>.

In the absence, or inapplicability, of a force majeure clause, common law doctrines of impossibility and frustration come into play. These doctrines allow the party to rescind the contract under certain circumstances.

Under the frustration of purpose doctrine, the contract may be rescinded "if one party's mutually understood 'principal purpose' in entering into the contract is 'frustrated * * * by the occurrence of an event the non-occurrence of which was a basic assumption' of the parties." To rescind the contract using this doctrine, the "party must show that (1) a particular purpose was its 'primary purpose' in entering into a contract; (2) that purpose was 'mutually understood,' even if not mutually shared; (3) that purpose was substantially 'frustrated'; and (4) the 'frustration' was the result of circumstances that the parties mutually assumed would not occur—and, thus, the risk of the frustrating circumstance was not impliedly allocated to the party who later seeks rescission."

By modest contrast, the doctrine of impossibility of performance applies "'where, after the formation of a contract facts that a promisor had no reason to anticipate, and for the occurrence of which he is not in contributing fault, render performance of the contract impossible, the duty of the promisor is discharged, unless a contrary intention has been manifested * * *.' Impossibility includes "unexpected difficulty or expense" that approaches such an extreme "as to be outside any reasonable contemplation of the parties"

While your client may not want to rescind the contract, these common law doctrines may be used to engage a fruitful dialogue with the other side to the contract with the goal of revisiting the contract to address equitably this unprecedented time.

2. <u>Advise the client to keep detailed records</u>.

It is critical for your contractor clients to keep accurate contemporaneous documentation on the impacts of this pandemic for multiple reasons. First, the contract likely requires documentation and notice contemporaneous with the event giving rise to the claim. Second, in the event of a dispute, contemporaneous documents have much more credibility with a fact finder than after-the-fact recreations based on memory and assumptions. Third, contemporaneous documentation shows the cause and effect relationship between the event and the delay.

4. <u>Review your client's insurance policies</u>.

Insurance on large projects is highly customized and could include coverage for "soft costs" including "time-element" or delay. Coverage, however, is typically triggered by physical damage to the project itself. Nevertheless, it is possible that "soft costs" coverage could be written in such a manner that it could be triggered by a "civil authority" directive to shut down the project untethered to specific physical damage. Moreover, for projects in the pipeline, talk with your insurance professional about available insurance products for your future projects. Have your clients review their insurance portfolios (or hire experienced coverage counsel to do so) to determine if there is coverage that can mitigate the impact of a construction delay or COVID-19 related shutdown of your project. Then, advise your client to talk with their insurance professional about available products for future projects to see if there are insurance products available that make sense for the contractor and/or the future project.

5. <u>Confirm compliance with social distancing and OSHA regulations</u>.

Workforce safety has been a mantra in construction for decades. This pandemic presents a novel overlay to workforce safety. Your contractor clients should designate, in writing, the person on site at each project who is authorized to implement and enforce mandated social distancing policies. Further, after this pandemic passes we can reasonably anticipate new OSHA guidelines that will affect work sites and employment practices.

6. <u>Reassess projects</u>.

Assist your client in Re-evaluating its construction budget and schedule in light of the current impact on workforce availability, productivity, material cost, and supply chain impacts. To do this, encourage an open a dialogue with the project team, the owner, the design professionals, the lenders, the general contractor, the subcontractors, and the key material suppliers regarding the impact of this virus on the budget and schedule and the team's efforts to mitigate the impact on the project. Verify in writing the team's ability to perform and pass the verification, or lack thereof, upstream. No one will be alone or unaffected the virus. A proactive dialogue upfront may go a long way to avoiding expensive disputes down the road.

7. <u>Look to the future</u>.

This pandemic will eventually pass. Projects will restart. New projects will get underway. In moving forward, we must learn from the lessons this pandemic is teaching us. Insert a "Pandemic Rider" into current projects and draft a "Pandemic

Clause" into future contract that address the rights and remedies of the parties in the event this type of situation occurs again. An ounce of prevention is worth a pound of cure.

With clarity of thought and an eye toward to future, we can assist our clients through these unprecedented times and prepare our clients for the post-pandemic world that will emerge.

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## New Retainage Requirements Raise More Questions than Answers

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Recent amendments to ORS 279C.570 and ORS 701.420 create new requirements for retainage withheld on public and private construction contracts. Effective January 1, 2020, if the contract price exceeds $500,000, the contracting agency, private owner, contractor, or

Tom Ped

subcontractor must place amounts deducted as retainage into an interest-bearing escrow account. Interest on the retainage amount accrues from the date the payment request is approved until the date the retainage is paid to the contractor to which it is due.

The amendments provide no guidance on a number of issues, however, likely leaving clarification to the courts or further legislation.

A contracting agency, owner, contractor, or subcontractor is required to pay interest on the final payment due the contractor or subcontractor. However, interest was not required to be paid on amounts withheld as retainage. Under the amendments, those retainage amounts must be placed into an interest-bearing escrow account rather than remaining in the other contracting party's general operating account.

No guidance has yet been provided regarding how the escrow account should be established, how it should be managed, the extent of control an owner has over the funds while construction is in progress, or whether the funds can be used to cure a contractual default.

States with similar laws typically require that the parties enter a written escrow agreement; that the party withholding the retainage amount is responsible for the costs associated with establishing and administering the account; that the funds must be deposited in a federally insured account designated as an escrow trust account and kept separate, distinct and apart from funds belonging to the escrow agent; that the accumulated interest is payable to the contractor; and that failure to place the money into an interest bearing escrow account can result in criminal penalties and/or payment of damages to the party that is owed money.

The approaches elsewhere are not uniform. For example, in some states, the deposit, withdrawal, and/or disbursement of the subject funds may be subject to written approval of any party with an interest in the subject funds. Some states require monthly reporting or other notice requirements to the party performing the work. But, in at least one state, Alabama, the escrow agent is authorized to release subject funds upon default as determined by the party paying for the work. Nor is there consensus on whether amounts can be combined for cost and administrative efficiency. Two states sometimes allow retainage for multiple contractors to be held in a combined account, but at least one state requires each retention sum to be placed into its own escrow account.

Below is a discussion of questions that may arise in complying with the new requirements.

**Question:** What is an escrow account?
**Answer:** The term "escrow account" is not defined in the amendments. Presumably the Legislature intended to rely upon provisions from Oregon's Real Estate and Escrow Activities statutes, ORS 696.505 to 696.590. The term "escrow" is defined there as:

[A] transaction in which any written instrument, money, evidence of title to real or personal property or other thing of value is delivered, for the purpose of paying an obligation or effecting the sale, transfer, encumbrance or lease of real or personal property, to a person who does not otherwise have a right, title or interest in the real or personal property, to be held by that person as a neutral third party until a specified event happens or a prescribed condition is performed, when the written instrument, money, evidence of title or other thing of value is to be delivered by the neutral third party to a grantee, grantor, promisee, promisor, obligee, obligor, bailee, bailor or any agent or employee of any of them pursuant to the written instructions of the principals to the transaction. ORS 696.505(5).

"Escrow trust account" means a bank account that is:

(a) Kept separate, distinct and apart from funds belonging to the escrow agent;

(b) Designated as an escrow trust account; and

(c) Used to deposit trust funds received by an escrow agent on behalf of a principal.
ORS 696.505(7).

It is also important to remember that escrow agents for real estate transactions must be licensed. ORS 696.511. The amendments to the ORS 279C.570 and ORS 701.420 are silent on whether a licensed escrow agent must be used. Title companies may soon rejoice.

**Question:** Which party is required to pay for the administrative costs associated with establishing an interest-bearing escrow account?
**Answer:** It is likely that the party for whom construction services are provided will be responsible for paying for all costs associated with establishing and administering the interest-bearing escrow account. Although Oregon statutes regarding private contracts are silent on this issue, at least one regulation interpreting the parallel statute for public contracts disallows the public authority from recovering any costs incurred with establishing an interest-bearing escrow account. See OAR. 137–049–0820(7).


Cassie Bow

**Question:** Is it necessary to place retainage for different contractors into separate escrow accounts?

**Answer:** Unknown. Oregon's law is silent as to whether retainage funds of multiple contractors can be maintained in a single account. For further reference, at least three other states allow for the combination of accounts. As mentioned above, Alabama allows accounts to be combined; Ohio allows combination as set forth in written escrow agreement; Connecticut allows retainage amounts for different contracts but under the same contractor to be combined.

**Question:** Can the retention requirements be avoided altogether?
**Answer:** Possibly. In *Vic Davis Constr., Inc. v. Lauren Engineers & Constructors, Inc.*, E201700844COAR3CV, 2019 WL 1300935 (Tenn Ct App Mar 20, 2019), a Tennessee contractor avoided that state's retainage requirements successfully with a contract provision stating that "invoices are not subject to retention." The Tennessee Court of Appeals held that the state's retainage laws did not apply where the parties had expressly agreed that the invoices were not subject to retention.

**Question:** Is it a crime to use retainage funds to hire another contractor to cure defective work of the subcontractor?
**Answer:** Possibly. The law takes misuse of escrow funds seriously. Any violation of Oregon escrow laws is a Class A Misdemeanor. ORS 696.990(3). Arguably, therefore, the use of retainage funds to cure defective work could invoke criminal liability.

In sum, parties to construction contracts now face additional administrative tasks and expenses to comply with the new laws, the parameters of which are presently undefined and unknown. Contracting parties would do well to comply as best they can until more guidance is provided.

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## LEGISLATIVE TRENDS IN REGULATION OF ARCHITECTURE AND ENGINEERING PRACTICE

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With both the Oregon State Board of Architect Examiners (OSBAE) and the Oregon State Board of Examiners for Engineering and Land Surveying (OSBEELS) celebrating their 100th anniversaries in 2009, Oregon law relating to the regulation of the practice of architecture seems to be fairly stable. And it has been, with a few exceptions, for the past few decades. However, as the recent experience of other states shows, Oregon may not in the future be immune to the forces of deregulation that are targeting professional regulation on multiple fronts.

### Proposed Legislation in Other States

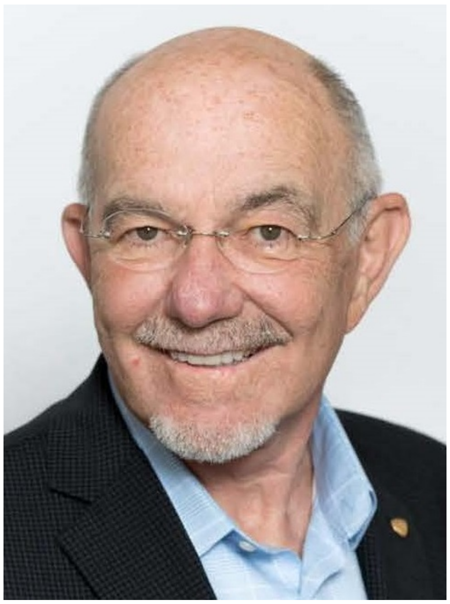
Just one state, Arizona, has specific architect and engineer deregulation bills pending in its 2020 legislature. Three additional states—Oklahoma, Rhode Island, and South Dakota—have had general deregulation bills introduced this year, and another dozen or so states have had legislation introduced that would reduce in some manner the effect of regulation in their states.

The bills in Oklahoma[1], Rhode Island[2], and South Dakota[3] are very similar in many respects, and add both mandatory "sunrise" and "sunset" reviews of occupational licensing. The sun<u>set</u> reviews require that, on a periodic basis, the state conduct a review of the regulation of selected professions and occupations to determine whether the regulatory scheme is the "least restrictive option" to protect the consumer. Sun<u>rise</u> reviews apply a similar set of criteria, generally more stringent, that must be met for any proposed regulation of a previously unlicensed profession or occupation.

The bill introduced in all three of these states also includes a presumption "that consumers are sufficiently protected by market competition and by

[1] S.B. 1678, 2020 Leg. 57th Sess. (Ok. 2020)
[2] H.B. 7359, 2020 Leg. (R.I. 2020)
[3] H.B. 1276, 2020 Leg. (S.D. 2020)

private remedies."[4] The reviewing body is, in each case, required to consider the existence of private certification programs that allow consumers to obtain information about a provider's knowledge and skills."[5] The committee assigned the Rhode Island bill has recommended that the measure be held for further study, but the bills in Oklahoma and South Dakota are still before their respective legislatures.



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The two bills introduced in Arizona go beyond the scope of the legislation proposed in the states discussed above. The first other would allow the practice of engineering by unlicensed engineers, by allowing any person whether licensed or not, to offer services as an engineer if the person can "by reason of engineering education, training and experience may apply engineering principles and interpret engineering data**."**[6] Operating under this definition, it appears clear that a person of limited education and experience could hold themselves out as an engineer in Arizona.

The other Arizona bill would dramatically change the membership of the licensing board for architects and engineers.[7] The Arizona Board of Technical Registration is a multi-disciplinary board with jurisdiction over licensing of architects, engineers, landscape architects, geologists, and land surveyors. By statue, its current composition is:

- Two architects,
- Three professional engineers, one of whom is a civil engineer, and the other two from other disciplines,
- One landscape architect,
- One geologist,
- One land surveyor, and
- One public member.[8]

Under the new legislation, the professional membership would be reduced, and public member positions increased to be a majority of the board. While current board members would be allowed to serve out their present terms, the ultimate composition of the board would then consist of:

- One architect,
- One professional engineer,
- One landscape architect,
- One geologist,
- One land surveyor, and
- Six public members, at least one of whom has a legal, construction, or design product background.[9]

It is expected that, if either or both bills are approved by the Arizona Legislature, Gov. Doug Ducey will sign them into law.

**What's Driving Deregulation?**

The drive for deregulation of architectural and engineering licensing appears to be primarily almost exclusively by two organizations: the American Legislative Exchange Council (ALEC) and the Institute for Justice. ALEC is an organization that reports over 2,000 legislators nationally among its

[4] *Id.* at 4.
[5] *Id.*
[6] S.B. 1298, 2020 Leg., 54th Leg. (2020)
[7] S.B. 1274, 2020 Leg., 54th Leg. (2020)
[8] Ariz. Rev. Stat. Ann § 32-302 (2018)
[9] S.B. 1274, *Id.* at 2.

members, and proposes legislation on conservative causes for introduction in the various states, including "stand your ground" laws.[10] It is understood that the sunrise- sunset licensing legislation currently pending in Oklahoma, Rhode Island, and South Dakota relied heavily on ALEC.

The Institute for Justice is not unknown in Oregon, having provided support to plaintiff Mats Järlström, a self-described but non-practicing engineer who was disciplined by OSBEELS for using the title "engineer" in his complaint about traffic signal timing in Beaverton. With the assistance of the Institute for Justice, Järlström prevailed in a suit against the OSBEELS board decided on a 1st Amendment free speech basis in 2018 that struck down Oregon's engineer title act.[11, 12] The Institute is apparently we well funded, and participates in litigation throughout the county relating to libertarian causes such as deregulation, and reportedly relies on substantial donations from the Koch family of Kansas.[13]

**What Does this Mean for Oregon Attorneys?**

Oregon attorneys who represent licensed architects and engineers, and also those who represent contractors, subcontractors, owners, and others who rely upon the accuracy and completeness of construction documents, should be interested in and aware of the forces of deregulation that affect their clients. For many years, regulation of design professionals on a state by state basis has been surprisingly uniform, given the differences in states' laws. However, that may not be true in the near future. Beyond that, while architecture and engineering are, for reasons not well understood, high on the list of those promoting deregulation, the same groups are also interested in the deregulation of other professions and occupations.

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[10] *See*, e.g. https://en.wikipedia.org/wiki/American_Legislative_Exchange_Council

[11] *Järlström v. Aldrige*, 366 F.Supp.3d 1205 (2018).

[12] In 2019, the title act was amended in response to the *Järlström* decision, *See* Oregon Laws 2019 c.75 §1.

[13] *See*, e.g., https://en.wikipedia.org/wiki/Institute_for_Justice

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