Construction Law Newsletter

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***Annual Construction CLE Save the Date**:*
October 21, 2022 at the OSB Center in Tigard OR and virtually – details to come!

Thanks to our authors!

Past Issues!
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CASE LAW UPDATE: OREGON COURT OF APPEALS RECOGNIZES NEGLIGENCE *PER SE* UNDER INSURANCE CODE

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On January 26, 2022, the Oregon Court of Appeals issued an opinion in *Moody v. Oregon Community Credit Union et al.*, 213 Or. App. 233, recognizing that an insurer's violation of ORS 746.230(1) in Oregon's Insurance Code can ground a negligence per se claim. ORS 746.230(1) prohibits certain "unfair claims settlement practices," such as misrepresenting facts or policy provisions, failing to communicate or investigate promptly, failing to conduct a reasonable investigation, failing to settle claims that are reasonably clear, failing to provide a proper explanation for the denial of a claim, and the like. This new opinion is significant.


Emily

Prior to the *Moody* decision, insurers generally believed their only exposure to tortious bad faith in Oregon arose after they accepted defense

coverage under a liability policy and assumed control of their insureds' defense in the underlying liability lawsuits. Conversely, insurers generally believed that simply denying defense coverage avoided all tort exposure, irrespective of the substantive merits of their denials. Insurers also generally believed that they were immune to tort liability in first party coverage contexts, such as property insurance. The Moody opinion upends all of those assumptions.

Under the new *Moody* decision, insureds can bring tort claims seeking a tort measure of damages when their insurers deny any kind of coverage in a manner that violates ORS 746.230(1). A tort measure of damages can cast a broader net for a larger recovery than a contract measure of damages. For example, in *Moody*, the plaintiff is a widow beneficiary under a $3,000 life insurance policy, and she is seeking $47,001 in damages for emotional distress caused by the insurer's denial of benefits in violation of ORS 746.230(1)(d) ("Refusing to pay claims without conducting a reasonable investigation based on all available information") and (f) ("Not attempting, in good faith, to promptly and equitably settle claims in which liability has become reasonably clear").

In holding that the widow plaintiff may proceed with her negligence per se claim for emotional distress damages, the Oregon Court of Appeals explicitly recognized that "an elementary principle of insurance law is that insurance policies do not merely provide for the payment of funds in cases of loss; they also provide the policyholder peace of mind." 317 Or. App. at 246. The court described this "peace of mind" as "a principal benefit of an insurance policy." Id. at 247. The court also concluded that "given that the very nature of insurance is that it is purchased to ensure peace of mind, it is hard to imagine that the legislature did not intend the law, at least in part, to prevent policyholders from being forced to experience the stress of dealing with unfair insurance claim settlement practices." Id. at 248.

The *Moody* case is now pending in the Oregon Supreme Court, and insurance attorneys throughout Oregon eagerly await final disposition by our state's highest court.

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ADJUSTING TO CONSTRUCTION IN THE SMART HOME TECHNOLOGY AGE

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Over the years, smart home technology has improved, expanded, and become more reasonably priced. As a result, homeowners are increasingly including it in their construction plans. While the conveniences of smart home technology are undeniable, the drawbacks deserve some attention, as well.

Typically, smart home technology allows a homeowner to connect to and control appliances and devices from anywhere, using a mobile or other networked device. The smart home system is typically run through software, and the devices are interconnected through the internet. These days, smart home technology extends to almost every system in the home including security, lighting and electricity, heating and cooling, and kitchen and other appliances.

As we know from our experience installing software updates on our computers and cell phones, software does not always operate as smoothly as planned. Glitches with smart home technology can lead to negative consequences that impact the home environment. A smart home technology malfunction can result in a device turning on or to the wrong setting without the owner's input. As with any other device, software updates and provider maintenance are often required to prevent or remedy system bugs or performance failures. If the product is discontinued or the developer goes out of

business, however, certain devices may no longer be supported with upgrades or updates. If a device becomes unusable, the homeowner may try to recoup its losses from the contractor that provided or installed it.

Another significant peril stems from the fact that the smart home devices are connected the internet. By now, people are generally familiar with the risks of emails and computers being hacked. We associate those hacks with a potential compromise of personal and financial information, creating an opportunity for property and identity theft. Smart home technology systems can also be hacked. The consequences, however, are arguably even more invasive than exposure of personal and financial data. A cybercriminal who gains access to the connected devices can, among other things, set the home's thermostat to dangerous internal temperatures, unlock doors, or access security cameras to spy on the people in the house.


Laurie

There are measures that a homeowner can take to minimize the risks of hacking, such as buying reputable and safe devices, installing upgrades when offered by the developer, and using safe passwords to secure the devices. That being said, the risks still remain, regardless of good intentions and practices.

What does all of this mean for a contractor that provides or installs smart home technology, or the attorney that represents it? Contractors should start by being informed about the smart home technology systems they are providing or installing. Just like some building materials are better quality than others, the same goes for smart home technology. If the contractor is aware that the customer has chosen a substandard system, the contractor should recognize the increased risk that the system may fail or be vulnerable to a hack and, therefore, include appropriate protections in its contract with the customer. For example, if an owner insists on using a sub-par system, the contractor may choose to simply exclude the provision and installation of such system from the project scope under its contract.

Contract provisions and notices may add another layer of protection. For contractors that may provide or install any aspect of a smart home technology system, consider including in the construction contract a written notice to the customer of the risks of software issues and hacks. Further, consider including in the contract a limitation of liability for these perils which are not caused by the fault of the contractor, as well as confirmation that it is the owner's responsibility to maintain the devices, update the software, and keep the system safe. Further, to the extent the contractor installs the physical devices, it may be appropriate for the homeowner to be the one to install the actual software since it will be the owner's responsibility to maintain and update the software going forward. Indeed, the contractor is providing building services, not IT services.

Additionally, having the owner install and maintain the software minimizes the chances that the contractor could be considered a "covered entity" subject to the Oregon Consumer Information Protection Act with respect to hacks to the smart home technology. Under ORS 646A.602, a "covered entity" that must give

notices of a breach of security "means a person that owns, licenses, maintains, stores, manages, collects, processes, acquires or otherwise possesses personal information in the course of the person's business, vocation, occupation or volunteer activities." A "covered entity" does not include a person that acts solely as a vendor, which is defined under ORS 646A.605(19) as a "person with which a covered entity contracts to maintain, store, manage, process or otherwise access personal information for the purpose of, or in connection with, providing services to or on behalf of the covered entity." Although there may very well be arguments that the contractor is not a "covered entity" in the event of a smart home technology hack, it would be better to avoid the need to make such arguments by simply not collecting the personal information necessary to install or update the software in the first place.

Another issue to consider is that the contractor's standard liability insurance may not cover some of the risks associated with smart home technology. For example, many policies exclude cyber risk, unless a special coverage endorsement is purchased. Contractors should consult with their insurance agent regarding insurance coverage that may be available in connection with providing and installing smart home technology. Further, consider adding cyber risk coverage to the standard insurance requirements provision in the construction contract with the owner. As an aside, contractors may want cyber risk coverage anyway, as more and more contractors' own computer systems and their emails may be subject to being hacked.

As the construction industry evolves and overlaps with the tech industry, contractors need to take a moment to initiate policies and procedures to protect themselves from the increased exposure that comes with this new territory. By staying informed, their counsel can help them with that process.

Laurie Hager is a commercial litigation and construction attorney in Snell & Wilmer's Portland office. This article is not intended as legal advice. If you need legal assistance, you should contact an attorney.

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WHAT DO THE RULES OF EVIDENCE HAVE TO DO WITH DOCUMENTING A CONSTRUCTION CLAIM? EVERYTHING

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Construction is document intensive. Construction disputes are equally document intensive. Given the critical role of documentation in preserving and resolving construction claims, it is essential that construction companies train the people who create and manage project documentation adequately. Otherwise, evidentiary challenges may sink an otherwise meritorious claim or defense.

This issue recently came to a head in *Arrowood Indemnity Co. v. Fasching*, 369 Or 214 (Feb. 10, 2022). While not a "construction" case, *Arrowood Indemnity* highlights the importance of proper document creation and management to preserve or defend a construction claim.

In *Arrowood Indemnity*, the plaintiff insured a loan. The defendant defaulted on the loan. Plaintiff paid the claim and sued defendant to recoup its payment. At trial, the parties filed cross-motions for summary judgment, each of which pivoted on whether documents plaintiff received from a third party were admissible under the rules of evidence, specifically the rule against hearsay, the out-of-court statement proffered for the truth of the matter asserted, which includes documents.

An important exception to the hearsay rule, particularly for document heavy construction

projects, is the "business records" exception. Under this exception, written business records may be admissible, even if the author is unavailable to testify, provided the author created the document based on knowledge of the event, near the time the event occurred, and as part of his or her regular record keeping activity.

In *Arrowood Indemnity*, Plaintiff argued documents from third parties qualified as admissible business records. Defendant disagreed, arguing that, in order for the documents to qualify for the business records exception, plaintiff had to present evidence about the record-making practices of the businesses that created the documents, and plaintiff failed to do so. The trial court agreed with plaintiff, ruling that "as long as the documents [were] received, incorporated, and relied upon" by plaintiff, the documents were "admissible as business records." The trial court granted plaintiff's motion for summary judgment, denied defendant's cross-motion for summary judgment, and entered a judgment in plaintiff's favor. Defendant appealed, which was affirmed by the Oregon Court of Appeals.

Defendants petitioned the Oregon Supreme Court to address the issue of what evidence a party must present to establish the business records exception. The Supreme Court held the party proffering the documents must present evidence of record-making practices sufficient to establish the documents were made contemporaneous with the acts they describe, by (or from information transmitted by) a person with knowledge, as part of a regularly conducted business activity, and pursuant to a regular record-making practice. Because plaintiff failed to present such evidence, the trial court erred in admitting the documents into evidence, remanding for further proceedings.

Applying Arrowood Indemnity to a construction project:

- Document the event at the time of occurrence. A daily field report summarizing an on-site conversation about a site condition may be excluded from evidence if the information about the conversation was written down days or weeks after the conversation took place. If too much time passes, such project documentation could be excluded from evidence as hearsay.

- Document what you know of the event. A letter from a project manager based on what the superintendent relayed to him or her may be excluded from evidence; the project manager may not have the firsthand knowledge to document the condition or occurrence accurately. While the rule allows the document to be written from information transmitted by someone with knowledge, the better practice is for the document to be written by a person with firsthand knowledge of the event.

Jacob

- Regularly keep records. An unexpected report, untethered to common record keeping practices, is suspect. Daily field reports should be kept consistently and uniformly. Inconsistent and irregular field reports could be inadmissible to prove critical events otherwise noted in the reports.

Project documentation is critical to any claim or defense. Proper documentation alone is only half the battle; the document must also be admissible as evidence in trial. Therefore, the people in the field should know how to document the events in a manner that ensures the document would be admissible as evidence in the event a dispute arises.

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PRESERVING INSURANCE COVERAGE WHILE SPECIFYING PERFORMANCE IN DESIGN AND CONSULTANT CONTRACTS

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Recently, I was negotiating a contractor-led design-build contract between my firm's architecture studio and a reputable general contractor in Oregon. As we worked through various obligations on the design team, I would link levels of effort and measures of performance to "the Standard of Care." We defined this in the typical manner as follows: "the skill and care used by members of the same profession performing similar services and practicing under similar circumstances at the same time and in the same locale." Otak's site observation reports would include documentation "as required by the Standard of Care," etc. Eventually, my counterpart at the general contractor pushed back, requiring more specificity, and making the point that architects may know what the "Standard of Care" is, but a general contractor or owner may not.

How many pictures should the "standard" architect take for an observation visit? How many visits? "You architects may know what the 'Standard of Care' is," urged my general contractor counterpart, "but I want to just say what you're going to do."

In *Pinnacle Architecture, Inc. v. Hiscox, Inc.*, the court had the opportunity to apply the concept that, "In Oregon, architects owe a professional duty of care to their clients that exists independent of contractual obligations." *Pinnacle Architecture, Inc. v. Hiscox, Inc.*, 543 F. Supp. 3d 997, 1006 (D. Or. 2021). This was a coverage case, where the insurance company resisted its duty to defend the architecture firm because the design contract required the architect to "to meet State of Oregon requirements for a Psychiatric Hospital, as defined by OARs." *Id.* at 1001. The insurer argued the architect only had a contract obligation, and the insurance policy had an exclusion "for any claim: ... based upon or arising out of any actual or alleged breach of any contract or agreement." *Id.* at 1002.

Justin

In *Pinnacle*, the insurance company lost because, "An insurer has a duty to defend if the factual

allegations of the complaint, without amendment, state a claim for any offense covered by the policy." *Pinnacle Architecture*, 543 F. Supp. 3d at 1007 (D. Or. 2021) (citing *Marleau v. Truck Ins. Exch.*, 333 Or. 82, 91 (2001)). This was anchored with the statement that, "In Oregon, architects owe a professional duty of care to their clients that exists independent of contractual obligations." *Id.* at 1006.

Together, my recent negotiation and this case raise the question of how far the parties can go in specifying professional services while aligning the Standard of Care with contractual obligations that preserve coverage and defense under the foregoing framework.

We are familiar with this in contexts modifying the Standard of Care itself, such as a client's insistence that services be performed "to the highest standard of care," or "the highest level of professional skill." These are easy outliers because of the direct elevation of the standard. When it comes to quantification of efforts, however, this becomes less clear.

The architect's lawyer may have a reasonable basis to anchor a quantification as representing the architect's own clarification of what the Standard of Care requires in a certain circumstance, and not as being an elevation of the standard of care itself. For example, in Pinnacle Architecture, the architect was committed to "[r]e-design floor plan to meet State of Oregon requirements for a Psychiatric Hospital, as defined by OARs [Oregon Administrative Rules]." *Pinnacle Architecture, Inc. v. Hiscox, Inc.*, 543 F. Supp. 3d 997, 1001 (D. Or. 2021). In delivering the project, the architects would have continued to add specificity to these requirements in implementing the design, but at all times the court nonetheless held that general requirement to be part of the overall Standard of Care obligation of the architect. Similarly, an architect may specify a certain number and type of site visits, while pointing to the fact that OAR 806-010-0050(1)(b) requires architects to visit the site "on a periodic basis as is necessary to determine that the work is proceeding generally in accordance with the construction documents." By specifying levels of effort within the established scope categories of the architectural practice, Pinnacle Architecture can stand for the premise that coverage and defense should not be impacted.

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MATERIAL ESCALATION CLAUSES – DIFFERENT WAYS TO ALLOCATE RISK

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Everyone is freaking out about rising material costs, and rightfully so. Over the last twelve months, construction costs increased 18.3% nationally and 18.6% in the Portland area market. (*see* https://www.mortenson.com/cost-index/portland). Costs for building materials remain escalated due to manufacturing issues and supply chain delays resulting from the COVID-19 pandemic, as well as rising fuel costs due to the Russian invasion of Ukraine. For construction contracts already in place, parties are either working through the cost impacts collaboratively, or else gearing up for a fight. Whether such certain clauses, including *force majeure*, can be used to address the rising material costs remains to be seen. But for projects yet to be inked, the material costs have become one of the primary topics of construction contract negotiations.

For the key players in the construction contracting chain, Owner, General Contractor, and Subcontractor, the risk of material price increases often cannot be avoided. For many building materials, a limited number of suppliers make it near impossible to hold those suppliers to quotes and timelines, even if used to establish bids and contract values at the front end of a project (without risking future work by poisoning relationships with the suppliers). Therefore, when the material price goes up, someone other than the supplier usually has to pay for it, or the project

simply won't happen. Accordingly, addressing material escalation costs in the contract documents is essential to managing the parties' expectations.

Based on some recent negotiations, below are a few ways parties have attempted to address the risk of rising material costs in prime contracts and subcontracts.


Alex

I. Percentages

The easiest way to allocate risk due to material escalation costs is to set a percentage change in those costs that must be met before a Subcontractor or General Contractor can seek an adjustment to the contract value. Whether it is one percent, five percent, or ten percent, setting some minimum amount of change in material cost can help to avoid the down-stream parties from taking advantage of poor bidding or slight price increases that may have nothing to do with the supply chain or global disruption in the construction products market.

II. Timing

One of the more equitable ways to allocate the risk of material cost increases is to limit the time for a Subcontractor or General Contractor to request an adjustment to the contract value due to material costs escalations. For example, a prime contract may limit requests for changes to the contract value to the first 60 or 90 days following the issuance of a notice to proceed. This timing limitation is equitable because it does not hold a General Contractor or Subcontractor to their initial bids, which may have been presented many months prior to the project actually getting underway. But once the project starts, the contractor parties must act swiftly to secure subcontract and or supply agreements and "lock in" pricing. If pricing changes after that, it is on that party to manage its relationships and should not be the responsibility of the upstream party. This also allows upstream parties to better anticipate increased costs early on the manage the project finances and avoid late cost surprises.

III. Specific Trades

As between Owners and General Contractors, one way to allocate risk is to select specific trades for which a change in the contract price is permissible. For example, the parties may agree that material cost escalations associated with framing (lumber) and concrete (rebar) are allowed to be added to the project costs, but electrical and other trades are not. How to chop of the different trades would likely be different in each negotiation, but it does allow for the parties to share in the gamble that is the construction materials market.

IV. Contingency/Savings

Parties wisely are weary to allocate any portion of their contingency to specific issues, as that may limit their flexibility in construction. Nevertheless, parties can apportion some amount of the potential risk of material cost escalation to the project contingency. Similarly, if a contract

includes a savings clause, that can be the "bucket" of funds that gets hit first if there is a substantial material cost increase. This may be especially useful to ease the parties' comfort level within certain financing requirements.

V. Payment for Materials

One way for Owners and General Contractors to help Subcontractors mitigate the risk of material cost escalation is to modify the standard language regarding payment for materials. Often, contracts limit the amount and the time for which Subcontractors can submit a pay application for material costs. For example, often payment will not be made until the materials are delivered to the site and made part of the project. By allowing Subcontractors to request payment earlier on, an Owner or general contractor can allow the Subcontractor to pre-purchase the materials and store them off-site, but still get paid for them. By providing this consideration, it makes it easier to hold Subcontractors accountable for their contract price.

VI. Delays

The same external factors driving up material costs also impact the production and delivery timelines. Parties should consider the potential impact to the project schedule due to supply chain issues when negotiating these types of clauses.

VII. Documentation

At a minimum, any material escalation clause should require the party seeking an adjustment to their contract value to prove it. That means providing details information to show the material cost increases as compared to the original bid. This might include quotes, purchase orders, etc.

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