Construction Law Newsletter

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***Annual Construction CLE Save the Date**:*

October 6, 2023 at McMenamins Edgefield and virtually – details to come!

Thanks to our authors!

Past Issues!
https://constructionlaw.osbar.org/newsletters/

CONTRACTOR OR HANDYPERSON: DISTINCTION WITH A DIFFERENCE

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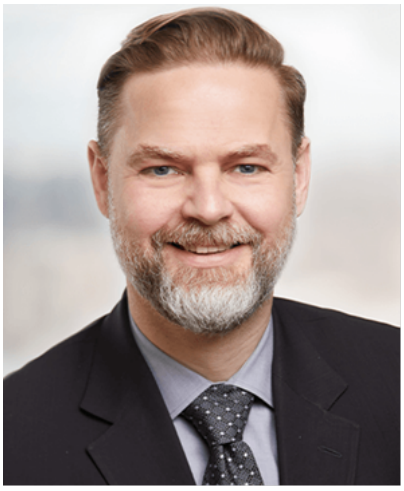

Many owners with odd jobs around their property consider hiring a handyperson over a contractor to save time and money. A handyperson is generally unlicensed, uninsured, unbonded. By contrast, a contractor should be licensed, bonded, insured, and typically more expensive than a handyperson. A handyperson crossing the line into the business of a contractor risks a heavy toll—a handyperson who should have been licensed as a contractor generally cannot invoke the court to seek payment for their work. Telling the difference between a handyperson and an unlicensed contractor is a fact specific exercise. Oregon and Washington have similar licensing laws and follow similar fact specific analysis to determine if someone is a handyperson or an unlicensed contractor.

Oregon

In order for a contractor in Oregon to bring a claim for compensation, the contractor must have had a valid, current license in place, from the time it first contracted with the property owner to the time it completed the work. ORS 701.131. In

Roelle v. Griffin, 59 Or App 434 (1982), the Oregon Court of Appeals explained as follows:

> A builder may choose, for whatever reason, to ignore the law and operate without registration. If he does so, however, he may not call upon the courts to help him collect his pay. In agreeing to undertake work on defendants' residence without a valid registration, plaintiffs entered into an illegal agreement. They were subject to criminal, as well as civil, penalties for their action

59 Or App 434, 439 (1982); *see also Pincetich v. Nolan*, 252 Or App 42, 47 (2012) (observing ORS 701.131 "serves to deter unlicensed contractors from performing construction work by denying them the ability to pursue claims for compensation for their work."); *Bannister v. Longview Fibre Co.*, 134 Or App 332, 336 (1996) (affirming dismissal of unregistered contractor's breach of contract and tort claim; "the statute prohibits the maintenance of an action by an unregistered contractor 'for compensation for the performance of any work' of the kind to which ORS chapter 701 applies").

By contrast, handypersons do not have to be licensed by the Oregon Construction Contractors Board (CCB). In *Nichols v. Baggarley*, 79 Or App 505 (1986), the Court held a handyperson was exempt from the CCB licensure requirement, finding the handyperson to be an employee, not an independent contractor. To reach its holding, the *Nichols* court observed the following: first, "plaintiff did not hold himself out to be a contractor" because "he was basically a handyman who performed odd jobs." 79 Or App at 510. Next, the Plaintiff "had no business cards or business telephone and did no advertising. He did not solicit defendant's business; instead, she contacted him while on her mail route and asked him to perform work for her." Finally, plaintiff "made no bid" and "received an hourly wage" as opposed to a lump sum for the work. Based on the evidence, the *Nichols* court "conclude[d] that plaintiff was working for wages, rather than as an independent contractor, and he [was] therefore exempt from the registration requirement under ORS 701.010(8)." *Id*.

Drawing the line between contractor and handyperson, the *Nichols* court found the following factors compelling: (a) did the person hold him or herself out to the public as a contractor; (b) did the person perform odd-jobs or a defined scope; (c) did the person actively solicit business; and (d) did the person bid a scope of work or receive an hourly wage. 79 Or App at 510.

Washington

Like in Oregon, in order for a contractor in Washington to bring a claim for compensation, the contractor must be licensed by the Department of Labor and Industry (L&I) at the time they contracted for the performance of the work. RCW 18.27.080. While this may result in a windfall to the owner, in *Vedder v. Spellman*, 78 Wn.2d 834 (1971), the Washington Supreme Court explained as follows:

> The legislature has taken account of the fact that persons who contract with unlicensed contractors are often victimized and it has determined that an effective method of protecting the public from such contractors is to deny recovery to one who has actually performed work which he unlawfully contracted to perform.

78 Wn.2d at 838; *see also Bort v. Parker*, 110 Wn App 561, 571 (2002) ("[A]n owner contracting with an unregistered contractor generally cannot be compelled to pay the contractor. * * * Effectively, an unregistered contractor has no standing to seek redress from the courts if the person benefiting from the fruits of his unlicensed

labor refuses to pay. * * * The bar to recovery for unregistered contractors extends to alternative remedies such as unjust enrichment") (citations omitted).

Like in Oregon, handypersons in Washington do not have to be licensed by the L&I. For example, in *Rose v. Tarman*, 17 Wn App 160, 163 (1977), a bulldozer operator was not required to be registered with L&I because the operator's work was "not in the pursuit of an independent business" but arose out of an agreement between two friends with a long-standing social relationship, in which one agreed to provide bulldozing services to the other.

Recently, in *Dobson v. Archibald*, Case No. 100862, 2023 WL 1830503 (Feb. 9, 2023), the Washington Supreme Court considered the dividing line between contractor and handyperson, adopting the following rule set forth in Rose:

> In determining whether or not an individual is a contractor in the pursuit of an independent business, the court considers (1) the nature of the relationship with the client [e.g., "a referral-based, businesslike relationship" or a social relationship beyond the business transaction], (2) the time of performance, (3) the agreed-upon price for performance and whether it is substantially below the going rate for similar work, (4) the public perception of the individual's role in performing such work [i.e., is the public "likely to believe that someone who gets" referral-based work arising from "business relationships" is "in fact a contractor"], and (5) which party solicits the contract.

Slip Op. p. 10, 2023 WL 1830503 * 4.

Like in *Nichols*, drawing the line between contractor and handyperson, the *Dobson* court engaged in a fact specific analysis based on numerous factors.

In either Oregon or Washington, unlicensed handypersons need to be careful not to cross the line into being a contractor requiring a license. For lawyers representing owners or handypersons, delve early into the facts to establish whether this is a handyperson situation or an unlicensed contractor situation.

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A Recent Court of Appeals Decision Bears on Insurance Coverage for Repair of Construction Defects

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In a February 15, 2023 decision in *Twigg v. Admiral Insurance Company*, 324 Or App 259 (2023), the Oregon Court of Appeals held that an insurance company was not required to indemnify its insured based on a claim for breach of a repair agreement that settled underlying construction defect claims.

As background, the Twiggs hired a contractor, Rainier Pacific, to construct a new home. The Twiggs then filed a first arbitration against Rainier Pacific alleging, among other things, that a portion of the work was defective. The first arbitration was resolved through a settlement agreement which the parties referred to as the "Repair Agreement." Under the Repair Agreement, Rainier Pacific was required to repair certain alleged construction defects.

The Twiggs then filed a second arbitration alleging that Rainier Pacific had breached the

Repair Agreement by failing to perform the repairs required under the Repair Agreement. The arbitrator awarded $604,594.80 to the Twiggs for the total cost to perform the repairs that Rainier Pacific had failed to adequately complete under the Repair Agreement.

Rainier Pacific had a commercial general liability insurance policy from Admiral Insurance Company, under which Admiral agreed to cover Rainier Pacific's liability arising from property damage caused by an occurrence. An occurrence is defined in the policy as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." After Admiral denied indemnity coverage, the Twiggs sought to collect on their arbitration award by asserting a claim against Admiral for breach of the general liability insurance policy.

The trial court dismissed the Twiggs' coverage claim against Admiral, and the Twiggs appealed. The Court of Appeals ("the Court") affirmed the trial court's dismissal ruling on appeal.

In its decision, the Court notes that the Twiggs' written arbitration claim was informal and did not set forth numbered allegations or labeled claims, but was generally framed as a breach of the Repair Agreement. With respect to the arbitrator's ruling, the Court found as follows:

> [T]he arbitrator concluded that [certain] repairs had been completed, but that the installation was "defective" and contrary to the manufacturer's specifications. … The arbitrator concluded that Rainier Pacific, "through its consistent failure to diligently prosecute the work, and through its defective efforts to repair the garage slab, materially and substantially breached the [Repair] Agreement." The arbitrator finally concluded that the Twiggs' "relief is based upon common-law principles of breach of contract."

324 Or App at 264-5. The Court concluded that the claim asserted by the Twiggs in the second arbitration did not allege property damage based on an "occurrence." Rather, the Court held that the claim was for breach of Rainier Pacific's contractual obligations under the Repair Agreement, which is not a claim covered under the insurance policy. The Court relied heavily on the fact that the Twiggs' arbitration claim was presented, defended, and ruled on by the arbitrator as a single claim for breach of contract.

All that being said, the Court acknowledged that "[t]here is no doubt that a repair contractor's negligent work that accidentally caused damage to physical property could give rise to an occurrence under the policy."

The Court's decision allows for different outcomes under distinguishable facts. For example, the Court's decision suggests that it might have ruled differently had the arbitration claim clearly alleged a distinct claim for negligence that caused resulting property damage. Additionally, if the performance under the Repair Agreement had led to new property damage that was not already required to be repaired under the Repair Agreement, that might have also led the Court to a different conclusion. Additionally, it appears that the Admiral policy did not cover the underlying defects that led to the first arbitration that was resolved through the Repair Agreement and, therefore, the Twiggs could not argue that the underlying defects from the first arbitration constituted property damage that Admiral was required to cover under the policy.

A contractor that enters into separate contract to repair originally defective work should be aware of the Admiral coverage case ruling, as it may affect the contractor's ability to receive indemnity coverage for related property damage.

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RETAINAGE OVERHAUL? CROSS YOUR FINGERS!

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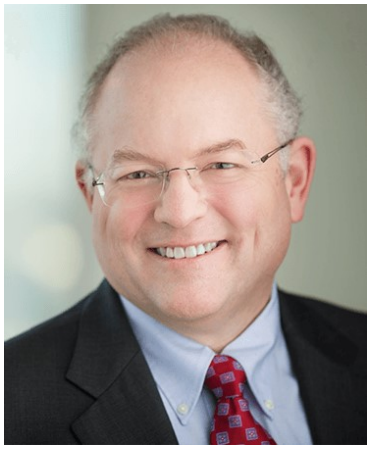
Help may be on the way to stabilize Oregon's public and private retainage law, which has been in confusion since January 1, 2020, when HB 2415 (2019 Session) (the "2019 law") required



that all public and private construction contracts of $500,000 or more hold retainage in interest-bearing escrow accounts. *See* ORS 279C.570(2) and 701.420(2)(b), quoted below. The 2019 law fails to provide crucial information about how to implement its requirements, which has created substantial confusion and contradictions in practice. Also, no competitive market for the contemplated escrow accounts has developed, making compliance difficult at best. All corners of the industry have sought answers and solutions.

A new bill in the current Oregon legislative session, HB 2870, would repeal the 2019 law and replace it with an expanded opportunity to use retainage surety bonds, in which a contractor or subcontractor could require payment of retainage upon posting a surety bond guaranteeing against claims that retainage is intended to address. The bill, as amended (*see* B-Engrossed version), can be found at https://olis.oregonlegislature.gov/liz/2023R1/Measures/Overview/HB2870

The Problem: Securing Prompt Payment of Retainage

Retainage is considered a form of security for the public contracting agency or private owner to ensure the contractor's full and faithful performance of the general contract or, in the case of a subcontract, to ensure the subcontractor's full and faithful performance to the general contractor. Retainage on public improvement contracts is or may be required by statute or regulation. ORS 279C.570(7). For private construction contracts, retainage is a creature of the parties' contract and is allowed, but not mandated, by law. ORS 701.420(1). When retainage is agreed upon, Oregon law limits it to a maximum of five percent of the contract price. *Id.*; ORS 701.420(1); *see also* ORS 279C.555.

The failure of prompt and full payment of retainage has been an issue, particularly for subcontractors, for many years. As examples, (1) early subcontractors (e.g., excavators) must wait for their retention until the owner tenders final payment to the general contractor for the entire project; (2) subcontractors must wait for payment until unrelated disputes between the owner and general contractor (or other subcontractors) are resolved; and (3) retainage accumulates over a long period without earning interest, causing the time-value of the retained amounts to drop.

The 2019 Law: General Confusion and Lack of Critical Answers

In the 2019 Oregon Legislature, the 2019 law was intended to be a simple and elegant solution to

contractors' (particularly subcontractors') concerns about prompt and full payment of retainage on significant construction contracts. For public improvement contracts, it requires:

> If the [public improvement] contract price exceeds $500,000, the contracting agency shall 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. (ORS 279C.570(2).)

For private construction projects, the 2019 law requires:

> If the contract price exceeds $500,000, the owner, contractor or subcontractor shall place amounts withheld 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 or subcontractor to which it is due. (ORS 701.420(2)(b).)

(These provisions apply to construction contracts entered into on or after January 1, 2020. Or Laws 2019, ch 486, § 3.)

Unfortunately, this simple elegance created a number of difficult issues in practice, including, without limitation, these concerns:

1. When is the $500,000 threshold measured? For example, if a $400,000 subcontract has change orders during the work that raise the contract price over $500,000, does the statute apply? If so, when—at the time it exceeds $500,000 and thereafter, or retroactively to the subcontract date or date of commencement of the subcontract work?

2. If a subcontract exceeds $500,000, must two escrow accounts be established—one for the prime contractor and one for the subcontractor?

3. Practically speaking, how does one find an Oregon escrow firm willing to take on these types of escrow accounts? There is no competitive market for this service. A couple of banks dipped their toes in the water early on, but it is not clear whether they still provide this service or, if they do, at what cost.

4. May the parties waive or modify the application of the statute? For example, could the parties agree in their contract to deposit retention in an interest-bearing account that is not in escrow or hold all retention at the owner level? What if the owner and prime contractor agree on a plan, but a subcontractor does not agree to it?

5. What rate of interest applies and when does it begin to accrue? Is interest payable to the contractor net of the costs of the escrow and the interest-bearing account?

6. On private projects, lenders or investors generally hold the cash designated for retainage and they are not governed by the 2019 law. This leaves the 2019 law's requirements in place for owners and general contractors, without any actual money to deposit in escrow or to invest. Must the owner or contractor deposit its own money in escrow to front the eventual payment from the lender?

No consensus has developed about how to properly address these concerns. Parties are left to negotiate their own solutions, which vary widely. Some ignore the statute, more or less. Others contract around the escrow requirement but allow for payment of some form of interest on the retainage. Many negotiated solutions attempt to waive some or all of the 2019 law, release claims

arising from it, or seeking indemnity from each other for violating it.

To be effective, any negotiated work-around must be implemented in every tier's construction contracts. Negotiated solutions between only owners and general contractors would not bind a subcontractor, who could then make a claim under the 2019 law even if its terms have been interpreted, modified, or waived in the prime contract.

The main, unknown legal concern is whether a court would uphold any of those work-around terms. To date, we are unaware of any trial or appellate court decisions that interpret the 2019 law, much less any construction contract terms that seek to interpret, modify, or waive the 2019 law.

Working Toward a Legislative Solution

In mid-2020, the Construction Law Section executive committee convened a task force of Section lawyers representing clients in all corners of the construction industry to propose legislation to improve the 2019 law. After some discussion, the task force determined that too many policy decisions would be required to repair or replace the 2019 law, and bar sections may seek only "improvements of the law" that do not include policy changes. So, the task force became an independent committee and worked within the industry to propose new legislation. The committee connected with AGC Oregon-Columbia Chapter and grew to consist of Kirsten Adams (AGC), Jeremy Vermilyea, Gary Christensen, Darien Loiselle, Jim Cheney, Douglas Gallagher, and John Killin, with the assistance of Ian Campbell, who determined to find a better route to achieve the goals of the 2019 law. The committee worked with Representative Paul Evans (D-Monmouth) to develop and introduce HB 2870 in the 2023 Oregon Legislative Assembly.

Retainage Surety Bonds and HB 2870

HB 2870 had its first hearing on February 27, 2023, before the House Committee on Business and Labor. The committee has since drafted two amendments to the bill to address certain stakeholder concerns. As of publication, HB 2870 is being considered in the Senate in B-Engrossed form, which addresses additional stakeholder concerns and cleans up language. The B-Engrossed version of the bill should be reviewed rather than the original.

HB 2870 relies on an improved version of the retainage bond option already found in Oregon law. To improve it, the committee referred to the retainage bond statute used by public contractors in Washington, which provides a good model. (of note, Washington enacted a bill in April 2023 to expand its public retainage bond program to cover private construction, as well). HB 2870 principally modifies ORS 701.435 and 279C.560.

Here are the main features of HB 2870:

- HB 2870 will apply to construction contracts and subcontracts entered into on or after January 1, 2024. The 2019 law will then be repealed going forward, but it will continue to apply to construction contracts and subcontracts of $500,000 or more entered into between January 1, 2020 and December 31, 2023. Construction lawyers will still need to be versed in how to address the many questions raised under the 2019 law for some time yet.)

- HB 2870 applies only to (1) public improvement contracts that require retention and (2) large commercial structures, as defined in ORS 701.005(11) ("not a residential structure or small commercial structure," see ORS 701.005(15) and (17)). Retainage for other contracts can proceed without the option or restrictions of HB 2870.

- Contractors and subcontractors can avoid or stop retention on qualifying public improvement contracts and large commercial

structures by choosing to post a retainage surety bond. The public and private owner is required to accept the bond and stop retainage.

- If a prime contractor posts a retainage surety bond, it must accept requests from subcontractors to post similar bonds on their behalf. A subcontractor bond can be provided by the subcontractor, or the contractor can charge the subcontractor the cost of obtaining its bond (or the incremental cost to include the subcontractor in the prime contractor's bond).

- An approved form of retainage surety bond is included in the statute, which will avoid many disputes about its terms and sufficiency.

- If retainage has already been withheld, it is to be released to the contractor at the time that the retainage surety bond is posted.

- The retainage surety bond is subject to all claims, liens, and priorities to which the retainage would have been subject.

- Instead of using a retainage surety bond, the contractor and subcontractor may (1) submit securities, commercial (debt) bonds, or other approved collateral in lieu of retainage, or (2) elect to have the owner or contracting agency either place accruing retainage in an interest-bearing account (but not escrow) or simply pay interest on the accumulated retainage at the rate of 90-day commercial paper plus two percent.

HB 2870 (B-Engrossed) appears to have a reasonable chance to be enacted this session. The committee would appreciate any feedback, questions, comments, and (of course) support to assist in passage of HB 2870. Feel free to contact the committee members: Kirsten Adams, Jim Cheney, Gary Christensen, Douglas Gallagher, Darien Loiselle, John Killin, or Jeremy Vermilyea.

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PERSONAL GUARANTEES IN SUBCONTRACT AGREEMENTS

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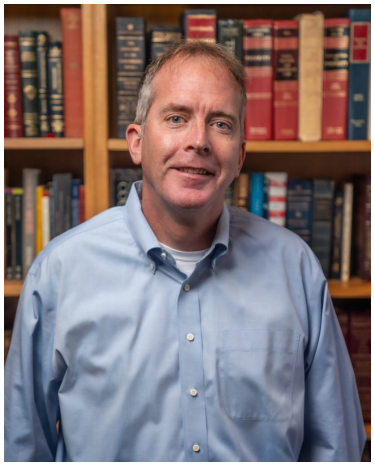

The subcontract may be the most employed agreement in the construction industry. The upstream contractor uses the subcontract to "push down" part of its scope of work to a specialized trade. Construction subcontract agreements are vanilla and predictable. The drafting or reviewing construction attorney can anticipate the same provisions using stock language: scope of work, payment terms and timing, insurance and indemnity, warranty, independent contractor, retainage, lien releases, safety and compliance with laws, dispute resolution, termination rights, blah blah blah. Wrinkles are rare. One wrinkle recently confronted on a few occasions is a purported "personal guarantee" provision seeking to obligate the principal of an entity subcontractor. (This article does not apply to the naked sole proprietor construction contractor. Which should never happen.)

The subcontract personal guarantee generally consists of a couple paragraphs and states that the principal signing on behalf of the subcontractor entity shares the entity's obligations and personal financial responsibility for obligations, losses, and damages owed to the upstream contractor. The supposed effect is the upstream contractor may go outside the entity shield and seek to recover financial loss from the principal's personal real property, bank accounts, income, and other assets. The provision is one way with no reciprocal

personal guarantee by the principal of the upstream contractor.

The question addressed by this article is whether the subcontractor principal's personal guarantee is worth the ink (referred to herein as the "Downstream Guarantee").

Personal guarantees are part of everyday dealings in the financial and commercial world. Lenders, landlords, vendors supplying on credit, and others facing at risk transactions are motivated and wise to obtain personal guarantees to incentivize compliance with payment obligations and provide an alternative source of recovery in the event of entity failure. Personal guarantees are important and standard where a party is extending credit or other capital to a new business or other obligor with inadequate collateral to cover amounts extended.

The Downstream Guarantee seems inapposite to the usual personal guarantee scenario. In the flow down of payments standard for construction, the subcontractor is typically the creditor fronting labor and materials to the upstream contractor with an expectation of later payment.

The upstream contractor's financial risk under a subcontract, on the other hand, is hypothetical and undefined. Financial loss under a subcontract only springs in the event the subcontractor fails to perform or some other unanticipated event. An upstream contractor has several tools to protect itself, such as the rights provided by the standard subcontract, retainage, bonds, warranties, and insurance. When choosing which tool to choose, pursuing enforcement of a personal guarantee is clearly the worst and last tool to protect an upstream contractor from financial loss.

That "moreover" for putting a personal guarantee next to the Yankee Driver in the tool box is provided by Oregon decisional and statutory law concerning the enforceability of personal guarantees. Enforcement of a personal guarantee may entail a facts and circumstances inquiry into entry of the guarantee and the subsequent performance of the subcontract. Such an inquiry should be read as code for "money and risk." The saying goes that "the only thing personal guarantees guarantee is extended litigation." An addition to the adage in the Downstream Guarantee should be "and troubling attorney fee exposure under the subcontract's prevailing party attorney fee clause."

Guarantees are simple to draft, often involving not more than a paragraph. The interpretation and enforceability of a guarantee, however, are not necessarily restricted to the four corners of the guarantee. Extracontractual factors may be at issue, and assuredly are in construction subcontracts. Some concerns arising out of the Downstream Guarantee are summarized below.

Ambiguous Scope: A provision requiring a principal to guarantee "all financial loss" to an upstream contractor is inherently and unavoidably ambiguous. The guarantor's potential liability at the time of subcontract entry is non-specific and entirely contingent. The normal scenario is potential liability would remain nothing more than a contingency as the subcontract is performed without unexpected financial loss to the upstream contractor. The exception may arise when some unexpected delay, improper construction, or accident occurs during subcontract performance.

At that unanticipated point, the general guarantee language does not specify the risk, nor does it specify the amount guaranteed. Consider efforts to pin personal liability on the principal of a siding subcontractor with a $47,000 scope of work for $250,000 delay claim. It would involve a huge challenge proving the general vague language reflected the intent of the parties. *See* ORS 42.220 (circumstances including "situation of the subject and of the parties" may be considered in interpretation); ORS 42.230 (guarantee construed as what is "contained therein, not to insert what has been omitted, or to omit what has been inserted").

Consideration and Materiality: Oregon decisional authority remains distinguishing a gratuitous guarantor from a compensated guarantor. *Marshall-Wells Co. V. Tenney, et al*, 188 Or 373 (1926). There is some question whether that distinction remains viable today. *See Marc Nelson Oil Product v. Grim Logging*, 199 Or App 73 fn 6 (2003) (1996 adoption of Restatement (Third) Suretyship and Guarantee eliminated distinction between compensated and gratuitous guarantors).

Regardless, as mentioned above, subcontracts consist of the same predictable provisions, except scope of work and price. Those issues are specifically negotiated as part of every construction subcontract. It is hard to imagine that a personal guarantee would be included in negotiations. While a personal guarantee's stock language may purport that the subcontract was awarded in consideration of the guarantee, that is very unlikely to pass the straight face test. While not a complete defense, the secondary nature of an atypical term would be a glaring issue in efforts to enforce.

Modifications: Well drafted subcontracts contemplate construction as a process as opposed to static and unyielding. The scope of work, obligations, timing of work, and other conditions may and typically do change during the construction process.

A material change in risk may result in a guarantor being discharged entirely. In *Lloyd Corp. v. O'Connor*, 258 Or 33 (1971), the court consulted the Restatement of Security for the rule that:

> Where, without the surety's consent, the principal and the creditor modify their contract otherwise than by extension of time of payment
> (a) The surety, other than a Compensated surety, is discharged unless the modification is of a sort that can only be beneficial to the surety, and
> (b) The compensated surety is
> (i) discharged if the modification material increases his risk, and
> (ii) not discharged if the risk is not material increased but his obligation is reduced to the extent of loss due to the modification.

Answering the question of "consent" and "material increase of risk" are factual questions requiring analysis of much more than the language of the guarantee. *See Fassett v. Deschutes Enterprises, Inc.*, 69 Or App 426 (1984); *Samuelson v. Promontory Inv. Corp.*, 85 Or App 315 (1987); *Marc Nelson Oil Products v. Grim Logging*, 199 Or App 73 (2005).

ORS 30.140: Finally, the dreaded anti-indemnity statute on its face applies to guarantors.

> (1) Except to the extent provided under (2), any provision in a construction agreement that requires a person or that person's surety or insurer to indemnify another against liability for damage arising out of death or bodily injury to person or damage to property caused in whole or in part by the negligence of the indemnitee is void.
> (2) This section does not affect any provision in a construction agreement that requires a person or that person's surety or insurer to indemnify another against liability for damage arising out of death or bodily injury to persons or damage to property to the extent that the death or bodily injury to persons or damage arises out of the fault of the indemnitor, or the fault of the indemnitor's agents, representatives, or subcontractors.

Oregon law treats personal guarantors as sureties. *Lloyd Corp., supra*.

Conclusion: Personal guarantees may seem simple in concept and a provision with little downside from the perspective of the upstream contractor. Enforcement of a personal guarantee can involve a true fist fight and vastly superior tools are available to protect an upstream contractor from financial loss. One attorney's opinion only, but even in an increasingly paperless world it is challenging to value the Downstream Guarantee as worth the ink.

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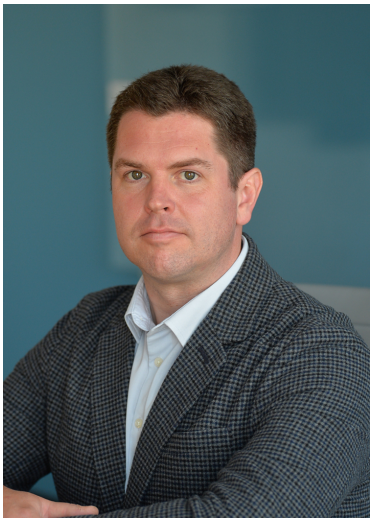
Professional Services Exclusions in General Liability Policies

Justin Monahan
Otak, Inc.



Typically, Commercial General Liability Policies issued to firms that offer registered professional services such as architecture and engineering include an exclusion to the CGL coverage for damages from the work of the firm in providing "professional services." It would seem that registered design professionals do a lot of things that would not constitute "the practice of" their professional discipline. We could argue this includes certain administrative functions related to a given scope of work or providing "Related Services" such as those defined in ORS 279C.100. However, depending on the insurance language involved and the description of the services, practitioners should be aware that an insurance company may argue the definition of "professional services" in a firm's CGL policy is broader than a colloquial understanding of what it means to provide "professional services." Insurers may argue that even though a given service may not require a stamp, or seem to be a "professional service," nonetheless it falls within an exclusion in the CGL policy.

A typical insurance endorsement in this area, CG D3 80 10 11, includes the following definition:

> The following is added to DEFINITIONS (Section V): "Professional services" means any service requiring specialized skill or training including:
>
> a. Preparation, approval, provision of or failure to prepare, approve, or provide any map, shop drawing, opinion, report, survey, field order, change order, design, drawing, specification, recommendation, warning, permit application, payment request, manual or instruction;
>
> b. Supervision, inspection, quality control, architectural, engineering or surveying activity or service, job site safety, construction contracting, construction administration, construction management, computer consulting or design, software development or programming service, or selection of a contractor or subcontractor; or
>
> c. Monitoring, testing or sampling" in performing the above.

Notably this provision attempts to address a few cases nationally that argued a "failure to warn" in a situation where it was argued a professional had a "duty to warn" of a dangerous condition was not itself the provision of professional services. *See North Cntys. Eng'g, Inc. v. State Farm Gen. Ins. Co.*, 2014 Cal. App. LEXIS 235 (Cal. App. 1st Dist. Mar. 13, 2014); *see also S.T. Hudson Eng'rs, Inc. v. Pennsylvania Nat'l Mut. Cas. Co.*, 189 N.J. 647 (App. Div. 2007). Similar arguments were raised in the more recent case involving the tragic collapse at Florida International University. *See Travelers Indem. Co. v. Figg Bridge Eng'rs, Inc.* 389 F. Sup. 3d 1060 (S.D. Fla 2019).

There is recent caselaw nationally to support the argument that criminal acts by an employee should not be classified as "professional services" in an action for negligent supervision and training against an employer. *Westchester General Hospital, Inc. v. Evanston Insurance Company*, No. 20-14814 (11th Cir. Sept. 16, 2022). However, that is a fringe event that is not much use to the daily efforts of lawyers working in the construction and design industries. Most of us would just rather have to pursue coverage under a Professional Liability policy, rather than deal with a fact pattern based on an employee's criminal acts.

While there are additional arguments that will continue to be made in qualifying and analyzing professional services exclusions, outside of that, another avenue for potential coverage is through the Additional Insured status afforded to those in owner's representation and project management roles afforded under the construction contractor team's policies. It is not always clear from the owner's contract with the construction contractor whether a consultant falls under the scope of that separate contract responsibility, where the consultant is not a direct party to the construction contract. For those advising consultants in that position, it does not hurt to ask of the owner that it include a provision in its separate construction contract identifying the consultant as an express third-party beneficiary of the Additional Insured status under the construction contractor's policies.

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