construction law report

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Recent Washington Cases Could Open the Door to Increased Liability

by Wendy J. Paris

It is well established in Washington that a tort claim for negligent construction is not allowed. A plaintiff is limited to whatever remedies might be available under contract. Compare that to Oregon, where courts recognize the tort of negligent construction allowing plaintiffs to bring negligence claims against a builder/contractor.

Washington's economic loss doctrine prohibits plaintiffs from recovering purely economic damages in tort when plaintiffs' entitlement to the damage is based in contract. *Alejandre v. Bull*, 159 Wn.2d. 674, 683 (2005). The economic loss rule seeks to bar recovery for alleged breach of tort duties where a contractual relationship exists and losses are economic (compared to personal injury or property damage).

In 2010, a trio of decisions in Washington appeared to have opened the door to allow tort claims where there is a contract.

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Oregon Court of Appeals Rules on Statutes of Limitations and Ultimate Repose

by Robert W. Wilkinson

The Oregon Court of Appeals recently issued a decision in favor of Ball Janik's client, the Sunset Presbyterian Church, that provides guidance on the time period allowed to bring a claim where an AIA contract is used. This case serves as a reminder that, in Oregon, the project completion date is of paramount importance.

The Sunset Presbyterian Church hired a contractor to construct the first phase of its new church facility. The parties used an AIA contract that included a claim-accrual provision defining "substantial completion" of the project as the date that the project architect certified the project was substantially complete. The church held services in the new facility in February 1999, and held a dedication event the weekend of March 13-14, 1999. After that weekend, construction work continued, including changes to the electrical system, fire-alarm system, and landscaping. In 2009, after discovering construction deficiencies, the church filed an action against the contractor and its subcontractors. The contractor and its subcontractors filed for summary judgment on the ground that the church's claims were time-barred.

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Recent Washington Cases Could Open the Door to Increased Liability

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Those cases recognize the "independent duty doctrine" as the basis for finding tort liability outside the contract, thereby allowing negligence claims. The most important decision in the trio allowed homeowners to sue a construction professional under a tort theory. The case involved a claim by a purchaser of a residence which was damaged by a large sinkhole. The original owner hired a plumbing contractor to repair the waterline. After the sale, a large sinkhole formed and was filled. The sinkhole formed again and was not repaired and eventually burst, causing a landslide which damaged the home. The second homeowner sued the plumbing contractor, and the contractor moved to dismiss, arguing that the economic loss rule barred recovery and, further, that no contractual privity existed. The court rejected both arguments and allowed the suit to go forward.

"This is a substantial departure from the long-established rule limiting claims to breach of contract."

Builders and developers should be aware that Washington courts now appear to recognize their liability for injury or damage to a third person as a result of negligent work, even after completion and acceptance of the work, when it is reasonably foreseeable a third person would be injured due to the negligence. This is a substantial departure from the long-established rule limiting claims to breach of contract. In 2012, in an unpublished opinion, the Court of Appeals found that a violation of a building code may be evidence of negligence.

In reviewing the application of the "independent duty" doctrine the courts appear to be limiting its application to claims arising out of construction on real property. The lessons learned from these cases is that Washington appears more open to allowing negligent construction cases, either coupled with breach of contract actions or alone. When evaluating claims in Washington, think outside the box to determine if there is an independent duty outside the contract, or if there is a violation of an applicable building code. Washington may be moving closer to recognizing negligent construction just like its neighbor, Oregon, which will afford homeowners a greater ability to recover for construction defects.

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D & O Insurance: Directors and Officers Coverage or Dead and Obsolete Coverage?

by James L. Guse

Homeowners associations routinely purchase Directors and Officers ("D&O") insurance. At first blush, purchasing D&O insurance is a wise risk-management tool. Upon close inspection, however, associations may be surprised by the limitations of D&O policies.

D&O policies purport to cover both the association and its directors to the extent they are found liable for "wrongful acts" committed by insureds. In other words, if a former director is sued for the commission of a wrongful act, the insurance is intended to compensate the injured party. Typically, the injured party is the association and its members. However, D&O policies now almost universally include some form of "insured v. insured" exclusion. Examples from two D&O policies are set forth below.

This insurance does *not* apply to claims:

> "By, or for the benefit of, or at the behest of the Organization [Association] or a Subsidiary or any entity which controls, is controlled by, or is under common control with the Organization or a Subsidiary, or any person or entity which succeeds to the interest of the Organization or a Subsidiary."
>
> "Brought or maintained by or on behalf of an insured organization unless the 'Claim' is brought and maintained totally independent of, and totally without the solicitation, assistance, participation or intervention of any officer, director or trustee of an insured organization."

Deciphering the insurance-speak, the policies exclude claims against current or former directors if the claim is brought by the association. Therein lies the problem: home-owners associations rarely, if ever, operate outside of the board of directors. In fact, if the claim relates to common elements or common funds, the association may be the only party with standing to bring such a claim. As a result, the D&O coverage provides little protection to an association or its members for wrongful acts committed by current and former directors and officers.

Some may question the existence of an exclusion that essentially guts any meaningful coverage. The exclusion first appeared as a result of "collusive" or "friendly" lawsuits by corporations: when a company's directors and/or officers made a bad business decision resulting in a loss to the company,

"Companies and associations can rarely trigger coverage for the wrongful acts of their officers and directors"

the company sued its officers and directors to recover the loss. In other words, insurance companies were asked to cover failed business decisions instead of legitimate wrongful acts. Insurers responded by excluding claims by companies against their own directors and officers.

Unfortunately, the insurance companies cast too wide of a net. While the exclusion certainly curtailed "friendly" lawsuits, the "insured v. insured" exclusion also all but precluded legitimate lawsuits. Companies and associations can rarely trigger coverage for the wrongful acts of their officers and directors, despite the fact that this is the very reason the coverage was procured.

Accordingly, before buying D&O coverage, one should discuss the "insured v. insured" exclusion with one's insurance agent or broker as the insurer may be willing to delete or modify the exclusion. Otherwise, associations should recognize that their premiums for D&O coverage might be little more than a donation to their insurance company.

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Oregon Court of Appeals Rules on Statutes of Limitations and Ultimate Repose

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Relying on the AIA contract definition of "substantial completion," the contractor argued that "substantial completion" occurred when the church actually started to use the facility in 1999. The subcontractors had a different argument: they argued that the claims against them were time-barred by the ten-year statute of ultimate repose which began when each separate subcontractor's work was completed and accepted by the contractor. The trial court agreed, and dismissed the church's claims. Ball Janik appealed the dismissals.

As to the contractor's argument, the Court of Appeals determined that the contractor had failed to present any architect certification as required by the AIA contract. Without evidence of the architect certification of "substantial completion," the Court of Appeals refused to enforce the contract provision at issue.

"Without evidence of the architect certification of 'substantial completion,' the Court of Appeals refused to enforce the contract provision at issue."

As to the subcontractor arguments, the Court of Appeals determined that the ten-year statute of repose does not start when the general contractor accepts the work of the subcontractors, because that would lead to different ten-year deadlines depending entirely on the completion dates of each subcontractor's work. Instead, the Court of Appeals ruled that the ten-year period of repose should start to run for all claims on one date: when the owner or developer, for whom the project is constructed, either (1) states in writing that the project is complete; or (2) accepts the project as complete and takes over responsibility for maintenance, alteration, or repair of the project. In the case at hand, there was no evidence that the church provided a written acceptance of the work. What was key, then, was the date when the church actually accepted responsibility for the completed project. The Court of Appeals noted the evidence that after March 14, 1999, construction work actually continued, including changes to the electrical system, fire-alarm system, and landscaping. Therefore, the Court of Appeals concluded that a genuine issue of material fact remained as to whether the church accepted the project as complete more than 10 years before the church filed its claims. As a result, the Court of Appeals reversed the trial court's dismissal, and reinstated the church's claims.

The Sunset Presbyterian decision provides guidance to all parties on the statutes of limitations and ultimate repose. Analysis of whether a claim is timely or not is still tricky, and experienced legal counsel should be consulted for advice.

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Timing is Everything: What is the Statute of Limitations for Negligent Construction Claims in Oregon?

by Adele J. Ridenour

Oregon courts have recently struggled with an important and complex issue in construction defect cases: just what is the statute of limitations for negligent construction claims? Until a few years ago, most trial courts ruled that the statute of limitations was six years from when an owner discovered or reasonably should have discovered a claim. See ORS 12.080(3) (which governs claims for injuries to interest of another in real property). However, some courts were persuaded that the statute of limitations fell under ORS 12.110(1), which is two years from discovery or reasonable discovery. In 2010, the Oregon Supreme Court alluded that the latter two-year statute is the correct statute. However, the reference to the two-year statute of limitations was buried in a footnote, and the statute of limitations was not even at issue in the case. The footnote therefore appeared to have left more questions than answers, including in particular just what was the precedential value of the Supreme Court's footnote.

More than two years later, we are still no closer to knowing with certainty the statute of limitations for negligent construction claims in Oregon. In general, most trial courts have now adopted one of the following three approaches:

1. The 2010 Supreme Court footnote is not controlling, and the statute of limitations is six years from when an owner discovers or reasonably should have discovered a claim;

"[W]e are still no closer to knowing with certainty the statute of limitations for negligent construction claims."

2. The 2010 Supreme Court footnote is controlling, and the statute of limitations is two years from when an owner discovers or reasonably should have discovered a claim; or
3. The 2010 Supreme Court footnote is not controlling, and the statute of limitations is six years without a discovery rule.

This last approach has raised even more questions, including when does the statute begin to run? Some courts following approach No. 3 have held it runs from when damage occurs; other courts have held it accrues from completion.

Whichever of the three approaches a court follows, the debate over the correct statute of limitations for negligent construction claims rages on in Oregon, until the appellate courts and/or the legislature clear up the issue once and for all.

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Construction Contracts—Five Tips for Owners

by Christopher M. Walters

In a typical construction contract negotiation, the contractor starts with an advantage over the owner. It has negotiated dozens of contracts, typically using the same form, and knows what that form says. Owners often are not in as enviable a position. Most owners negotiate construction contracts (and for that matter, contracts with architects, engineers and other project professionals) on an occasional basis, and often accept boilerplate forms provided by the contractor without substantial discussion or negotiation. This article provides some basic guidelines for review and negotiation of construction contracts by Oregon property owners, their project managers and representatives.

1. Start With the Right Contract.

An owner must first decide whether to accept a contractor's proposal to start with its form, or instead prepare its own contract. In either case, the owner must establish whether the form under consideration is appropriate for the transaction. For example, contractors sometimes will present a standard construction form in cases where a hybrid design-build or construction-management form is more appropriate. Whichever form is selected, a careful initial review of the entire document is warranted, to determine whether it includes provisions that are consistent with fundamental transaction terms. For example, contractors often provide for consideration an unmodified version of a form published by the American Institute of Architects (AIA). Owners should recognize that the AIA publishes at least a half-dozen different forms of construction contracts, to deal with differing project complexities and structures, and that other organizations publish construction forms that may be more favorable to the owner, or more tailored to the construction format being used.

"In a typical construction contract negotiation, the contractor starts with an advantage over the owner."

2. Cover the Basics.

From an owner's perspective, the fundamentals of any construction contract are the definition and scope of work, time for commencement and completion, price, and closeout responsibilities. Each of these fundamental concerns may or may not be adequately covered in the contractor's proposal, or the standard language of its contract form. Forms typically include qualifications to each of these basic parameters, which may excuse the contractor from responsibility for expected performance. Some of these qualifications may be not be obvious. For example, while the standard AIA construction forms give the parties an option to negotiate liquidated damages for late performance, they also include a boilerplate clause where, unless changed, the owner waives all claims for loss of income or use arising from late project delivery. Thus use of the standard form without modification could leave the owner without practical remedy for late performance by the contractor.

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Similarly, contractors often present forms where compensation is stated on a time and materials basis, giving the owner no protection if costs exceed the owner's budget. Identification and consideration of such fundamental issues is critical.

3. Pre-Construction Considerations.

It is important that the contract properly allocate between the parties responsibility for such pre-construction matters as the contractor's review of site conditions, and the procurement of permits, insurance, and bonds. Standard forms may include provisions that are inconsistent with the owner's intent. For example, the standard AIA construction forms mandate that the owner purchase "all risk" builders risk insurance. An owner who signs such a form, without the purchasing such insurance, may be at risk of loss for claims that would have been covered by the policy, including potential claims from the contractor.

4. Consider the Construction Process.

The construction contract should clearly document the roles and responsibilities of the owner, contractor, and design professional during the construction process. Many boilerplate forms give short shrift to the role of the owner (and its project manager), and instead allocate to the architect rights that the owner may consider excessive. Conversely, many standard forms provide the contractor with multiple grounds for excuse if the project is delivered late or not in accordance with the owner's program.

5. Address Job Closeout.

A typical standard form will give a generic standard for project completion that, in most cases, is inadequate. For example, if the project should not be considered complete until an occupancy permit is issued or an inspection passed, say so. Consider including specific additional conditions for completion and release of retainage, such as provision of construction lien waivers and project manuals. Identify a time period and process for completion of punchlist work. Finally, review the provisions for resolution of disputes, to ensure they provided a balanced platform that promotes resolution instead of inducing claims.

A review of these basic considerations will help ensure that crucial project issues are addressed to the owner's satisfaction during negotiation of a construction contract.

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High Deductible Liability Insurance Policies Pose Potential Problems for Policyholders and Claimants

by Kevin Mapes

In recent years, the construction industry has seen an increase in the number of commercial liability insurance policies that are subject to significant deductibles or self-insured retentions. In some cases, the increased deductibles represent an effort by the policyholder to reduce the costs of insurance premiums. In others, the large deductibles or self-insured retentions are required by carriers issuing project-specific "wrap-up" insurance policies. In either case, however, large deductibles can have negative consequences when claims arise, both for the policyholder and for claimants looking to collect on insurance proceeds.

While deductibles and self-insured retentions serve similar purposes, and can have similar impacts, they have important differences. A deductible represents an amount that the insured must pay as part of a covered claim. Typically, where a deductible applies to a covered claim, the insurer will pay for defense and indemnity costs; the policyholder then has a contractual obligation to reimburse the insurer for the amount of the deductible. A self-insured retention, in contrast, represents an amount that the policyholder must pay before the insurer has any obligation under the policy, including any duty to defend. Both self-insured retentions and deductibles can be written on a per-occurrence or a per-claim basis.

Deductibles and self-insured retention, by design, will always impact the policyholder when an insured (or potentially insured) claim is asserted. Large deductibles or retentions will magnify that impact and can also pose a significant problem for claimants who are looking to the proceeds of an insurance policy to compensate them for their loss. In many instances, an insurance policy is the defendant insured's only significant asset. Where that insurance asset is subject to a large deductible, a claimant's ability to collect on a judgment may be limited. Moreover, even where an insurer is providing a defense, claimants may find it significantly more difficult to reach an insurer-funded settlement where a large deductible or self-insured retention is in play.

These issues can be especially pronounced in the context of residential construction defect claims. A $100,000 deductible or retention can present a major financial burden to many insureds, especially if the insured's financial condition has changed for the worse since the time the policy was underwritten and issued. In the case of a single-purpose developer entity, the insurance policy may be the insured's only remaining asset. A claimant may obtain a judgment against such an entity, only to be faced with an insurance company that refuses to pay based on the insured's failure or inability to satisfy the deductible or retention. In the case of multi-unit residential construction, the impact of large retentions or deductibles can be magnified, as insurers often take the position that the deductible or retention applies separately to each individual unit. Even an otherwise financially viable insured may find itself unable to satisfy a large deductible twenty, fifty, or a hundred times over.

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In the case of project-specific "wrap-up" insurance policies, large retentions or deductibles can impact the primary named insured (typically the owner/developer or the general contractor), prospective claimants, and enrolled subcontractors. Wrap-up policies are intended to insure all of the project participants

"Policyholders should, however, carefully consider the potential impact on future insured claims before purchasing a policy that is subject to a significant deductible or retention."

under a single policy, covering the developer, the general contractor, and the project's subcontractors. Such policies are also often subject to large deductibles or retentions. Responsibility for the retention or deductible can be addressed in various ways, but most commonly falls to either the owner/developer (an "owner-controlled" wrap policy, or "OCIP") or to the general contractor (a "contractor-controlled" wrap policy, or "CCIP"). What happens, however, when the developer is responsible for the retention or deductible and cannot pay it? Unless the enrolled subcontractors are prepared to step in and fund a large sum, the parties to the wrap-up insurance policy may be left without any coverage; in the case of a large self-insured retention, the parties may even be left without an insurer-provided defense.

Large deductibles or self-insured retentions can be attractive to insureds looking to reduce their insurance costs. Policyholders should, however, carefully consider the potential impact on future insured claims before purchasing a policy that is subject to a significant deductible or retention. Similarly, potential claimants should be aware that large deductibles or self-insured retentions could impact their ability to successfully execute on what otherwise appears to be adequate and available insurance coverage.

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ball janik overview

Founded in Portland, Oregon in 1982, Ball Janik LLP has earned a reputation for industry leadership in government affairs, government contracts, real estate and land use law, construction law, bankruptcy and creditor rights law, and commercial litigation.

Ball Janik LLP serves large and small businesses, state, municipal and local governments, associations and coalitions, schools and universities, and individuals. With more than 55 attorneys and government affairs specialists, we take a team approach to client representation. We leverage our combined professional skills to solve problems and achieve results for clients.

Ball Janik LLP's success and integrity have made it one of "Portland's Most Admired Professional Firms," according to the *Portland Business Journal*'s survey results of 1,800 CEOs in Oregon and southwest Washington.

construction law practice

Ball Janik LLP represents owners, developers, public agencies, contractors, subcontractors, and material suppliers in all phases of the construction process. Our construction counseling practice has grown out of our general representation of developers, owners, contractors, and public agencies. We provide specialized, experienced service in negotiating and documenting design and construction arrangements, including bids, contracts, specifications, and joint venture arrangements. We also represent major contractors and subcontractors, including one of the largest electrical contracting firms in the nation. Our representation in the construction contracting field has covered a wide range of projects, including high-technology computer plants, office parks, hotels, high rises, residential subdivisions, loft conversions, and major league sports stadiums. Ball Janik is also called in to handle construction disputes including mediation, arbitration, and litigation.

Our services include:

- negotiating public and private engineering, architectural, construction, and subcontract agreements
- construction defect and design and product liability claims
- construction disputes and construction lien claims
- insurance recovery of construction disputes against insurance carriers
- payment, performance and construction lien claims
- prosecuting and defending design and construction defect claims
- public works and infrastructure projects

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