SMITH FREED & EBERHARD P.C.

OREGON LAW UPDATE

case in point...

Subcontractors Liable for Contractual Indemnity

From the desk of Jack Levy: The Oregon Court of Appeals resolved some important legal issues in the *Montara Condominiums* case which I tried five years ago. The Court limited the reach of Oregon's anti-indemnity statute and defined the measure of damages for a developer's breach of contract "pay and chase" claim against its subcontractors.

Claims Pointer: 1) A developer may recover contractual indemnity from a subcontractor to the extent of the subcontractor's fault even if the indemnity provision violates the anti-indemnity statute; and 2) A subcontractor may raise diminution of value as a damages defense to a breach of contract claim if the scope and cost of repairs result in undue economic waste, but that defense needs to be supported with separate expert opinion on the amount of diminished value resulting from the non-compliant work.

Montara Owners Ass'n v. La Noue Dev., LLC, 259 Or. App. 657, 317 P.3d 257 (2013)

Montara was the first modern-era, large construction defect case to go to jury verdict in Oregon. It involved 35 condominium units in 9 buildings, the standard litany of water intrusion construction defect claims (leaky windows, decks, etc.), and resulted in a suit by the homeowners' association against the developer, who then sued 30 of the subcontractors and the architect whose work was at issue in the claim. The developer's insurer settled with the homeowners' association for $5 million based on a scope of repairs involving the re-siding (re-clad) of the project and replacement of all the windows. The developer also settled with all of the third party defendants except for the siding and framing subcontractors. Even though the developer recovered contribution from the settled parties, the developer went to trial against the siding and framing subcontractors on a breach of contract theory to recover the full $5 million settlement paid to the homeowners' association.

The jury gave the developer a verdict, but the damages awarded were very low: $43,711 against the siding subcontractor and $102,101 against the framing subcontractors. The defense theme on liability and damages was that the few defects at the project were technical and non-substantial, so re-cladding the whole project at a cost of $5 million would amount to economic waste. Pre-trial, the court also ruled that the developer's claim against the subcontractors for contractual indemnity was void, because the subcontract indemnity provision required the subcontractors to indemnify the developer for the developer's own fault and therefore violated Oregon's anti-indemnity statute, ORS 30.140.

On appeal regarding the measure of damages, the developer argued that the jury should not have been allowed to consider the subcontractors' economic waste argument because a developer is entitled to recover "benefit of the bargain" damages, defined as damages that arise from the breach of contract and which would place the developer in the same position as if the contract had not been breached. The Court of Appeals disagreed with the developer and upheld the subcontractors' requested jury instruction on damages. It held that damages may be based on either the cost of repair or, in the event of "economic waste," the diminished value of the project. The jury instruction read in part:

> "... The cost of replacement or repair is the correct measure of damage for defects in construction work unless that remedy generates undue economic waste. If you find that, except for technical, nonsubstantial, or immaterial departures by the defendants from the plans and specifications, the [framing] [siding] work is satisfactory, and that an award to [the developer] for claimed repair costs would result in gross economic waste, the proper measure of damages is not the cost of repair but rather the difference in the value of Montara as built and what its value would be if it had been built according to the contracts."

The Court of Appeals found this instruction to be a correct statement of the law and rejected the developer's argument that there should be an exception to the economic waste doctrine in the context of a dispute between a developer and it's subcontractors. However, the court reversed the

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jury's award, holding that it is the subcontractor's burden to affirmatively prove economic waste or diminished value and that the siding subcontractor (the only subcontractor involved in the appeal) failed to produce such evidence. Without such evidence, the siding subcontractor was not entitled to an instruction on the diminished value of the project as an alternative measure of damages.

With regard to the anti-indemnity statute, ORS 30.140, the Court of Appeals reconciled the two parts of that statute and an earlier case interpreting it - *Walsh v. Mutual of Enumclaw*. Part (1) of ORS 30.140 essentially says that a developer *cannot* get indemnity from a subcontractor for the developer's own fault, where part (2) essentially says, but a developer *can* get indemnity for the subcontractor's fault. The *Walsh* case previously held that an overly-broad indemnity provision - one which potentially requires indemnity for the developer - is *totally* void. However, *Walsh* involved a different set of facts - an injured subcontractor's employee's "action over" against a general contractor in which the subcontractor's (employer's) fault was not at issue. In *Montara*, which did involve allegations of subcontractor negligence, the court held that an indemnity clause that offends ORS 30.140(1) because it requires a subcontractor to indemnify a developer for the developer's own fault remains enforceable to the extent that it also requires the subcontractor to indemnify the developer for the subcontractor's fault.

The *Montara* opinion also addresses a number of insurance issues regarding what kind of pay-and-chase damages are recoverable, including whether payments made under certain insurance policy years are recoverable from a subcontractor which did not perform work in those years (no) and whether payments made under the developer's errors and omissions insurance coverage may be recovered from a subcontractor (no).

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