Offshoots and Contract Considerations

Mark Rauch, *General Counsel, CIS*
David Doughman, *Beery Elsner Hammond*

2010 CIS Annual Meeting & Risk Management Conference
February 3-5th, 2010 · Embassy Suites · Tigard, Oregon

Introductions

Mark Rauch, *General Counsel, CIS*
David Doughman, *Beery Elsner Hammond*

- Program Overview

Contract ABC's

(See "Contract Law In A Nutshell" handout for more detailed information)

Required Elements

- Offer
- Acceptance
- Consideration

Other Key Concepts

- Contracts of Adhesion
- Parol Evidence Rule
- Third Party Beneficiaries

Common Defenses

- Fraud
- Mistake
- Duress
- Impossibility
- Frustration of Purpose

Contract Risk Management

- CIS's Role
- Start by considering the nature of the contract, i.e.:
  - Type and duration
  - Bargaining strength
  - What are the risks?
  - Are they transferrable? Insurable?

Distinguish between contracting "Rules" and "Guidelines"

Risk Management, con't.

- Indemnity clauses

  1. Broad (A indemnifies B no matter what—even claims arising out of B's sole negligence)

  NOT OK IF YOU ARE "A"; GREAT IF YOU ARE "B"

  - Unenforceable in "construction agreements" (ORS 30.140)
  - Coverage problem "Sole negligence of indemnitee"

Risk Management, con't

- Indemnity clauses

  2. Limited (A indemnifies B when claim arises out of the acts or omissions of A in performance of contract)

  Generally OK

Risk Management, con't.

- Indemnity clauses

  3. Mutual (A and B indemnify the other party if claim arises out of the acts or omissions of "indemnitor" in performance of contract.

  Generally OK

Risk Management, cont.

- The OTCA "Agent" issue:

  Duty of public body under OTCA (non-waivable?) to defend and indemnify "any of its officers, employees, and *agents*…."

  "We want 'X' (not an employee) to do a project for us under a personal services contract. He doesn't have insurance and will only do it if we agree to indemnify him if he gets sued. Can we just spell out in the contract that he is our 'agent'?"

Risk Management, cont.

- "Agent" Issue, cont'd:

  See David's "Contract Law in a Nutshell" at 10.3….and

  Vaughn v First Transit, 346 OR 128 (OR 2009) copy included in handout materials. See pp 10, 11, 12.

Risk Management, cont:

- Insurance
- Typically liability limits at least equal to tort caps.
- Try to specify that CIS coverage is deemed to satisfy “insurance” and “insurance policy” requirements.
- Get certificates from contractors.

Risk Management, cont.

- CIS working on a web-accessible contract review guide
- When you are asking CIS to review, please
  1. allow sufficient time
  2. give us background information
  3. send the entire contract

Other Contract Hotspots and Tips

- Dispute Resolution
- Venue, Governing Law
- Warranties
- Liability Limitations

Frequently Asked Questions

Contract Review

Questions?

Session Title: Contract Review

Date: Feb. 4, 2010

Time: 3:30 to 4:30 PM

Presenters: Mark Rauch, CIS General Counsel

David Doughman, Attorney with Beery, Elsner & Hammond, LLP

Session Description:

This session will be a discussion of practical risk management considerations for public bodies and insurance agents in the negotiation and review of contracts, including risk transfer strategies, insurance coverage pitfalls to avoid, and provisions that should (or should not) be included in contracts. This session will not deal with public contracting law or surety bonding.

I. Introduction (Mark and David)
   A. Brief review of contract law basics
      1. The required elements
      2. Other typical provisions
      3. Common defenses
      4. Third party beneficiaries
   B. The limited role of CIS in contract review

II. First step: What kind of contract is it? (Mark and David)
   A. Type and duration (Is it a "construction agreement"—ORS 30.140)
   B. Bargaining strength of the parties
   C. Nature of the service or product: risky?

III. "Insurance" and risk transfer issues: (Mark)
   A. Indemnity provision.
      1. Broad
      2. Limited
      3. Mutual
      4. ORS 30.140
      5. CIS coverage provision

         TIP 1: Mutual Indemnity clause is generally safe and reasonable. Do NOT consent to indemnification for sole negligence of Indemnitee. See suggested language, No. 1.
   B. "Additional Insured" requirement

      TIP 2: NOT additional named insured

C. Insurance requirement
    1. Limits: what's acceptable, what's a deal breaker?
    2. OTCA tort cap and other revisions. State of Oregon as indemnitee.
    3. When indemnitee is not a public body.
    4. Language: Check "insurance" and ISO language

TIP 3: Try to get acknowledgement and acceptance of CIS Coverage Agreement. See suggested language, No. 2.

D. Subrogation issues
E. Pollution, asbestos and other potential pitfalls.

IV. Other contract review hotspots and TIPs (David)
    1. Dispute resolution
    2. Venue, governing law
    3. Warranties
    4. Liability Limitations
    5. Correction of faulty work—extension of warranty

V. Q and A

CONTRACT LAW IN A NUTSHELL

CITY COUNTY INSURANCE SERVICES ANNUAL MEETING

February 4, 2010[1]

1. What is a contract anyway?

1.1. No universally accepted definition exists. In general, it is a legally enforceable agreement creating an obligation or obligations.

1.1.1. Express contract: vast majority are in writing but may be oral as well. In a governmental context, it is highly recommended and often required that contracts be reduced to writing and signed by each party to the contract.

1.1.2. Implied contract: examples are everyday purchases, like buying a newspaper, lunch, clothes, etc. The contract is created by the parties' conduct – typically nothing is formally written or stated.

2. Basic elements.

2.1. An offer.

2.1.1. A commitment or promise to enter into a contract, where the contract's essential terms are certain and the offeror's (the person making the offer) intent to contract is clearly communicated to an offeree (the person to whom the offer is made).

2.1.1.1. A public agency solicits bids, or invites offers, when it advertises public contracts. The bids or proposals returned to the agency are typically "firm offers" that bind the offeror but do not bind the agency until it finally accepts the offer and awards the contract. *See* OAR 137-047-0310 and 137-049-0280.

2.2. An acceptance.

2.2.1. A manifestation of assent to an offer's terms in the manner required by the offer. Only the specific person to whom an offer is made can accept the offer.

2.2.1.1. Offers are made to the public agency as a corporate entity but may be accepted by someone other than the agency's governing body (e.g. council, commission, board, etc.) if that body has properly delegated its authority.

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[1] Presented by David F. Doughman, Esq. of Beery Elsner & Hammond, LLP. Beery, Elsner & Hammond is a Portland, Oregon full-service law firm that limits its practice exclusively to the representation of public entities.

2.3. Consideration.

2.3.1. Because promises are sometimes made in jest or without sufficient forethought not every promise will be enforceable. In order to be enforceable a promise must be made in return for "consideration." Consideration consists of two elements: (1) a bargained-for exchange and (2) legal detriment.

2.3.1.1. A promise is "bargained-for" if it is sought by Mr. X in exchange for Mr. X's promise and it is given by Ms. Y in exchange for Mr. X's promise. For example, they agree that Mr. X will wash the dishes if Ms. Y cooks the meal.

2.3.1.1.1. The bargain requirement exists to distinguish between enforceable promises and ordinary gifts. If Ms. Y says to Mr. X "I promise to buy you a new car," Ms. Y is not legally bound to buy Mr. X a car because Y's promise was not made as part of a bargain in exchange for some return benefit from X. In other words, no consideration exists for Ms. Y's promise.

2.3.1.2. "Legal detriment" exists if one promises to do something that one is not legally obligated to do (e.g. wash the dishes) or refrains from doing something that one has a right to do (e.g. stop smoking).

3. Bilateral versus unilateral.

3.1. A bilateral contract exists when mutual promises to perform are exchanged. For example, X promises Y that he will sell her 10 pens for which Y promises to pay X one dollar. Bilateral are the most common types of contracts and are likely to be the only ones used by public agencies.

3.2. A unilateral contract is one in which a promise is made in exchange for actual performance, as opposed to a promise to perform. For example, X promises to pay Y $200 if Y paints X's house. X has not asked Y for a promise to paint, but rather to actually paint.

3.3. The difference between the two is the extent of the obligations they impose. Once parties exchange promises in bilateral contracts they are obligated to perform those promises. In a unilateral contract the non-promising party is not obligated to perform and the promisor's obligation does not arise until the requested act is completed.

4. Statute of Frauds.

4.1. Generally most oral contracts are valid and enforceable. However, the law will only enforce certain contracts if they are in writing. The "Statute of Frauds" exists to prevent fraudulent claims by requiring written evidence of the claim.

4.1.1. Contracts made in consideration of marriage. A promise to give or pay property in exchange for marriage is unenforceable unless written.

4.1.2. An administrator or executor's promise to personally pay the debts of the estate must be in writing.

4.1.3. A promise to pay the debts of another (a surety) must be in writing.

4.1.4. Generally a contract for the sale of goods worth $500 or more must be in writing.

4.1.5. A contract for the sale or purchase of an interest in land must be in writing (e.g. mortgages, easement, purchase and sale agreements, etc.).

4.1.6. A contract that, by its own terms, cannot be performed within one year must be in writing.

5. Contracts of adhesion.

5.1. Also known as standard form contracts or "take it or leave it" contracts. They are usually enforceable, but depending on the relationship and relative knowledge of the parties courts may scrutinize such contracts.

5.1.1. Essentially, the less "equal" the parties the more likely a court will view an adhesion contract, or certain terms of the contract, as unconscionable.

5.1.1.1. Unconscionability includes an absence of meaningful choice on the part of one of the parties, together with contract terms that are unreasonably favorable to the other party. A court may refuse to enforce an unconscionable contract or unconscionable parts of a contract.

5.1.2. Judicial scrutiny is given primarily to consumer contracts where an individual person is the affected party. Public agencies are likely to be assumed to be an "equal" party for the purposes adhesion contracts, as are businesses.

6. Interpreting contract language.

6.1. Parties may disagree over what a contract term means. This includes subjective terms and special "trade meanings" of which one party is not aware or the use of a word by the parties that may differ from how the word would normally be used.

6.1.1. If all parties have attached the same meaning to a term in a contract a court will interpret it consistent with that meaning.

6.1.2. If the parties attach different meanings, it will be interpreted in accordance with the meaning attached by the party who did not

know or have reason to know of any different meaning used by the other party, assuming the other party knew or had reason to know the meaning attached by the first party.

6.1.3. If the parties have had prior dealings, courts will examine whether similar terms were used and how they were interpreted by the parties.

6.1.4. If the parties unknowingly assign different meanings to an important contract term a court would likely find the contract to be unenforceable.

6.2. Parol Evidence Rule.

6.2.1. The rule prevents the admission of preliminary negotiations, written documents, conversations and oral agreements in a trial concerning a contract's meaning because they are legally "merged" into and superseded by the subsequent written contract.

6.2.2. Most contracts contain a "merger" clause stating that the contract represents a complete agreement between the parties.

6.2.3. Evidence of an oral agreement subsequent to the contract's execution may be admissible, depending on the contract's language.

6.2.3.1. For public agencies any amendments to a contract should be in writing and signed by the parties in order to be effective. This is good policy because it is clear and avoids any debate about whether a post-execution amendment occurred or is effective.

7. Validity of Contracts.

7.1. Enforceable.

7.1.1. An enforceable contract is a normal contract that has legal effect and can be enforced by a court.

7.2. Void.

7.2.1. A void contract has no legal effect. One could say it was never a contract to begin with. An example is a contract to commit a crime.

7.3. Voidable.

7.3.1. A voidable contract has legal effect unless one party chooses to void it. Essentially, the party that may choose to void a contract did not possess the legal capacity to enter into the contract. The most common instances of voidable contracts are those entered into by minors or the mentally infirm.

7.3.1.1. With regard to public agencies, another example is a contract that is entered into without the requisite authority. For example, an employee of City X enters into a contract to build a new city hall. Unless the employee had been specifically delegated this authority, a court would treat this contract as voidable.

8. Third party beneficiaries.

8.1. Contracts typically confer benefits only on the parties to them. Sometimes two (or more) parties may enter into a contract for the benefit of a third party. Depending on the status of the third party, it may be able to sue on the contract if it is breached.

8.2. Intended versus incidental beneficiaries.

8.2.1. Only an intended beneficiary may sue to enforce a contract between two other parties.

8.2.2. Evidence of an intended beneficiary include:

8.2.2.1. The beneficiary is entitled to money under the contract.

8.2.2.2. Performance was to be made directly to the beneficiary.

8.2.2.3. The beneficiary can change the terms of the performance.

8.2.3. While an incidental beneficiary may receive a benefit under a contract they will not be able to sue to enforce it because they were never intended to receive any benefits. For example, a county may contract with a construction company to improve a roadway upon which many businesses are located. If the contract is breached and the road remains in disrepair, a business who abuts the roadway may not sue the contractor as it was never intended to directly benefit from the improvements.

9. Defenses.

9.1. A lack of capacity to contract.

9.1.1. *See* 7.3.1 above.

9.2. Economic duress.

9.2.1. A contract is voidable if a party was forced to agree to it by use of wrongful threat that prevented the party from exercising free will.

9.3. Misrepresentation.

9.3.1. A party may avoid liability if it can show the other party misrepresented material facts when the contract was negotiated.

9.4. Mistake.

9.4.1. A contract may not be enforced if the parties were mistaken about a basic or material fact or assumption.

9.4.1.1. Mutual mistake: the mistake under which both parties are acting must have a material effect on the agreed exchange.

9.4.1.2. Unilateral mistake: courts are less likely to rescind a contract where only one party is mistaken because the remedy deprives the non-mistaken party the benefit of its bargain.

9.5. Impossibility, impracticability and frustration of purpose.

9.5.1. After a contract is formed unforeseen circumstances may make performance of the contract impossible or of no value to one of the parties. In such instances courts may excuse nonperformance by one party on the grounds of impossibility, impracticability or frustration of purpose.

9.5.2. Impossibility.

9.5.2.1. Contractual duties are discharged if their performance is rendered impossible.

9.5.2.2. Courts require that performance must be objectively impossible (i.e. it is impossible for anyone to perform, not just the party claiming impossibility).

9.5.2.2.1. Exception: If a party becomes insolvent, it does not matter that a solvent party could perform the contract.

9.5.3. Impracticability.

9.5.3.1. Increasingly, courts will discharge duties that are commercially impracticable, though technically possible, to perform.

9.5.3.2. Performance is discharged if:

9.5.3.2.1. An event renders performance impractical without fault of one of the parties;

9.5.3.2.2. It was assumed that the event would not occur when the contract was executed; and

9.5.3.2.3. The party claiming impracticability did not assume the risk of the event's occurrence.

9.5.3.3. Increased costs will generally not constitute impracticability unless extremely unusual events are to blame (e.g. war, crop failure, acts of god, etc.). Absent such an event, market

volatility will not be considered an impracticability justifying nonperformance.

9.5.4. Frustration of purpose.

9.5.4.1. If the essential purpose of a contract is frustrated, the parties' duty to perform is discharged even if performance is possible.

9.5.4.1.1. Example: Mr. X places a deposit on a hotel room with the explicit understanding that he will invite guests to the room to watch a parade from the room's balcony. When the parade is cancelled Mr. X refuses to pay the balance he owed for the room's rental. Because the essential purpose of the contract (watching the parade from the room's balcony) is frustrated each party is likely to be discharged from performance even though Mr. X can still technically rent the room.

10. Issues unique to public entities.

10.1. Public contracting laws (ORS 279A, 279B and 279C) and their associated rules published by the Attorney General (OAR 137, divisions 46, 47, 48 and 49 – the "Model Rules").

10.1.1. The Oregon Public Contracting Code and the Model Rules govern the purchasing of goods, services and public improvements.

10.1.2. ORS 279A and OAR 137, division 46: general issues applicable to all types of contracts.

10.1.3. ORS 279B and OAR 137, division 47: addresses "goods and services" procurement.

10.1.3.1. However, "personal services" are to be let in accordance with a local agency's own rules, unless the agency chooses to award personal services in accordance with ORS 279B and OAR 137, division 47.

10.1.3.1.1. Highly recommended that local agencies draft their own rules governing the award of personal service contracts, as courts will defer to the agency's determination of what is a personal service and will defer to the agency's procedure in letting such contracts.

10.1.3.2. Service contracts for architects, engineers and surveyors are to be awarded consistent with ORS 279C and OAR 137, division 48, unless the agency has adopted its own rules for the award of such contracts.

10.1.4. ORS 279C and OAR 137, division 49: addresses public improvements.

10.2. Prevailing wage.

10.2.1. For all public works projects where the contract is worth more than $50,000, the prevailing rate of wage in the locality where the contract is being performed must be paid to those working on the project.

10.2.1.1. "Public works" is defined at ORS 279C.800(5) and basically refers to public improvement contracts "carried on or contracted for by any public agency."

10.2.1.2. Note that under ORS 279C.810(2)(b) prevailing wages do not apply to any public works project "for which no funds of a public agency are directly or indirectly used."

10.3. Duty to defend "agents" of public entities.

10.3.1. Under the Oregon Tort Claims Act an agent of a public entity is entitled to indemnification from that entity if the agent is sued by a third party. *See* ORS 30.285(1).

10.3.2. Distinction between agents and independent contractors.

10.3.2.1. Even if a contract between a party and a public entity states that the party is an independent contractor who will indemnify and hold harmless the entity from any suit brought by a third party, courts will look to the relationship between the party and the public entity to determine whether the party is subject to coverage under the OTCA.

10.3.2.2. Courts will consider (1) whether the party is performing a function that the public entity itself is authorized to perform and (2) whether the public entity retains the "right to control" the party's work. See Welker v. TSPC, 152 Or App 190, 202 (1998) (issues of fact will determine whether a contractor is an "agent" within the meaning of ORS 30.285 and ORS 30.287).

10.3.2.3. The more control a public entity exercises over a contractor the more likely that contractor is an agent for the OTCA's purposes.

10.4. Key points to review in contracts.

10.4.1. The Parties.

10.4.1.1. Are they specifically identified?

10.4.1.2. Is there another person that will benefit from the contract (e.g. third party beneficiary) and should that person be a party to the contract?

10.4.1.3. What is their relationship (i.e. independent contractor or an agent)?

10.4.2. Duties.

10.4.2.1. Is the subject matter sufficiently described?

10.4.2.1.1. In a contract for services, for instance, the contract should state that the contract is for the performance of services and those services should be clearly described. However, if the contract is for the sale of goods, it should clearly indicate that the parties have agreed to a sale of goods.

10.4.2.2. Are the contract's material terms described?

10.4.2.2.1. The contract should state clearly state how much the entity will pay for the goods or the service, and how cost changes will be handled, if at all.

10.4.2.2.2. The contract should clearly state when the service or good is due and what the consequences are for late performance.

10.4.2.2.3. Especially in contracts for public improvements, technical specifications should be precisely identified and explained.

10.4.3. Contract duration.

10.4.3.1. Will it expire at a fixed time, or upon an event, or will it be automatically renewed?

10.4.4. Breach.

10.4.4.1. Does it permit a party an opportunity to cure its breach before the non-breaching party can enforce its rights?

10.4.5. Warranties.

10.4.5.1. Does the vendor provide sufficient warranties for its good or service?

10.4.5.1.1. For example, when public entities purchase software and related support services from a vendor, the contract should require the vendor to warrant that it has the right to grant the licenses to the software, that the software and the entity's existing hardware and software will function seamlessly, that the vendor is not subject to any pending litigation that would impact its ability to deliver the software and support to the entity, etc.

10.4.6. Liquidated damages.

10.4.6.1. If the contract contains a liquidated damages provision does it adequately demonstrate that the amount is reasonable in light of the "anticipated or actual harm" caused by a breach, the difficulty of proving loss, and "inconvenience or infeasibility of otherwise obtaining an adequate remedy." Illingworth v. Bushong, 297 Or 675, 692 (1984). *See also* ORS 72.7180(1).

10.4.6.1.1. Any provision that does not adequately demonstrate why the amount is reasonable risks being treated as a penalty and being ruled void as against public policy.

10.4.7. Dispute resolution.

10.4.7.1. Must the parties submit to arbitration in lieu of going to court? If so, is the arbitration binding or non-binding? Must the parties mediate a dispute prior to arbitration or litigation? Who is responsible for such costs?

10.4.7.1.1. It is advisable for agencies to consult with their legal counsel regarding the pros and cons of each approach. There are times when arbitration makes sense and there are times when it does not.

10.4.8. Forum choice.

10.4.8.1. Which laws apply to the contract?

10.4.8.1.1. Out-of-state vendors' contracts typically contain language that the contract is governed by the laws of their state and that any suit must be brought in that state. If a vendor refuses to agree to Oregon law and venue controlling it is probably wise to reassess whether the contract should be awarded to that vendor.