REAL ESTATE, LAND USE, CONSTRUCTION, AND ENVIRONMENTAL LAW

GroundBreaking News™

Successor Tenant Liable for Unpaid Wages of Former Tenant

by Jeneé Hilliard
jenee.hilliard@millernash.com

by Kellen Norwood
kellen.norwood@millernash.com

The Oregon Supreme Court recently affirmed a decision by the Bureau of Labor & Industries ("BOLI") holding a successor business owner liable for the unpaid wages of its predecessor. *Blachana, LLC v. Bureau of Labor & Indus.*, No. S060789 (Or Jan. 16, 2014).

The "Portsmouth Club" operated in north Portland for decades. Five different businesses had operated a bar and restaurant in the same location—referred to continually as the "Portsmouth Club" by customers—since 1940. In 2005, the property was owned by CP Underhill, LLC ("CPU"), which operated a bar called the "Portsmouth Club" and a restaurant called "Mama's BBQ." CPU was owned and managed by a mother and son, Janet and Chris Penner. The business offered food and drinks and provided live music as entertainment. In February 2005, CPU decided to sell the business and lease the building to NW Sportsbar Inc. ("NW"). NW entered into a five-year lease with CPU and an agreement to buy CPU's inventory for $50,000 and the goodwill of the Portsmouth Club for $285,000.

NW operated its business in the leased building under the names "Portsmouth Club" and "Anchor Grill" from March 2005 until May 2006, providing food and drinks and live music as entertainment. By May 2006, NW was three months behind in payments to CPU under the lease and purchase agreement. CPU and NW negotiated an agreement in which NW surrendered the premises, business assets, and goodwill to CPU in exchange for CPU's releasing NW from its obligations under the lease and purchase agreement. One week later, Janet Penner formed Blachana, LLC, listing herself as the member and manager, and by June 2006, Blachana had commenced business operations in the building under the name "Penner's Portsmouth Club." Initially, Penner's Portsmouth Club did not operate a restaurant, but by May 2007, the Club was offering food and drinks and providing live music as entertainment under the name "Portsmouth Pizza and Pub." CPU still owned the building, but Blachana owned and operated the business.

When NW closed its business in May 2006, it failed to pay four of its employees for wages owed to them. The total unpaid wages equaled about $7,000. BOLI authorized payment to the employees of the wages owed to them, and these wages were paid from the BOLI Wage Security Fund. The owner of NW left town shortly after NW ceased operations in the building, and CPU, BOLI, and Blachana had no contact information for him. Ultimately, BOLI sought repayment from Blachana for the unpaid wages plus a 25 percent penalty because BOLI held that Blachana was a "successor to the business" of NW, even though Blachana (1) was not affiliated with NW, (2) did not employ any of the people whom NW had failed to pay, and (3) did not have a contractual relationship with NW.

The Court affirmed BOLI's conclusion that Blachana was a successor to

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Minimizing Risk in a Construction Contract: From a Contractor's Perspective

by LeAnne Bremer
leanne.bremer@millernash.com

Based on a survey of case law, several key areas often lead to disputes between owners and contractors on a construction project. Careful drafting of the construction contract can benefit both sides by clearly defining expectations, eliminating ambiguity, and reducing the risk of delay of performance or payment.

Clearly Define and Understand Your Responsibilities in the Contract

Not only is it important to be clear in the contract about the parties' responsibilities, but the parties need to know what those responsibilities are and follow through on them. Too often, construction agreements are long and unread. A contractor's failure to read and understand its obligations could result in nonpayment for services rendered.

In one relevant case, the owners hired an architect and builder to design and build the house of their dreams "overlooking the moving waters of Puget Sound amidst the serene splendor of the sun setting behind the towering Olympics." The architect did such a good job that the owners fell in love with the house design and wanted no other. Unfortunately for the owners, neither the architect nor the builder bothered to check King County code requirements for backyard setbacks or the location of the sewage system. The builder could not build the dream house as designed in the desired location.

According to the terms of the construction agreement, the builder agreed "[t]o give all requisite notices to the property authorities; obtain all official inspections, permits, . . . and pay all property and legal fees for same." To compound matters, and contrary to the contract, the builder began construction before issuance of the building permit, but King County stopped construction after discovering the code violations. The owners refused to pay the builder for work done up to that point, and the builder sued for payment. The court had no trouble concluding that the builder knew of the King County ordinances and setback requirements "and showed want of diligence and ordinary care in assisting the architects in misplacing the house on the lot." This knowledge, in addition to the builder's duties set forth in the contract to procure all permits, inspections, and official certificates, supported the owners' justification for nonpayment. The court noted that if the builder had followed the terms of the contract and withheld construction until King County issued the building permit, then the builder would not have performed uncompensated services. Lesson: Define and understand contractual obligations and perform them.

Be Clear About the Warranty Period

Warranties covering construction defects are a key provision in any construction contract. An owner will want as many warranties as possible and in effect for as long as possible. A contractor, on the other hand, wishes to limit both the scope and duration of any warranty.

In a representative case, a builder agreed to build a custom home. The construction contract spelled out the builder's duties, including the following: (1) all work was to be done in accordance with the provisions of the plans and specifications; (2) all systems were to be in good working order; and (3) all work was to be completed in a workmanlike manner, and was to comply with all applicable national, state, and local building codes and laws. The contract further specified that at the completion of the project, the builder would execute a certificate warranting the project for one year against defects in workmanship and materials utilized. The owners were also prohibited from bringing action related to the project after one year beyond the "completion" of the project or cessation of work.

At one point in the construction process, the owners signed a certificate of substantial completion. The certificate did, however, state that the contractor still needed to complete a punch list of items. Even though later the owner made final payment to the contractor, and Pierce County issued a certificate of occupancy, the contractor continued to repair and correct additional problems that arose after those points. The owner and contractor never did reach an agreement on all the repairs that the owner wanted, and accordingly, the owner sued the contractor for breach of contract and other claims. The contractor asserted several defenses, including that the owner was beyond the one-year warranty period to bring a claim. On that defense, the court ruled in favor of the owner. Key for the court was when "completion" occurred, which started the warranty period. The contractor argued that completion occurred when the owner signed the certificate of substantial completion, but the court agreed with the owner that completion had occurred when the contractor completed the punch-list items, which was a later date, thus extending the warranty deadline.

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Courts Disagree Over a Loan Guarantor's Liability

by Dana Rognier
dana.rognier@millernash.com

It's an all-too-familiar scenario for commercial lenders: a commercial loan has gone into default, and the borrower is unable to cure. The loan is secured by a deed of trust and a guaranty. The lender pursues a nonjudicial foreclosure. After the trustee's sale, a sizable deficiency remains. The lender turns its attention to the guarantor. Is the guarantor liable for the deficiency after the trustee's sale? Maybe, or maybe not. Division I and Division II of the Washington Court of Appeals disagree over this very question.

The general rule in Washington is that one is not entitled to pursue a deficiency judgment on an obligation secured by a deed of trust after a nonjudicial foreclosure. There are, however, limited exceptions to this general rule for commercial transactions. These exceptions are found in Washington's Deed of Trust Act, and more specifically the antideficiency statute (RCW 61.24.100). And while the appellate courts both agree that a commercial guarantor may, in certain circumstances, be liable for a deficiency judgment after a trustee's sale, their opinions diverge when addressing a very specific scenario—when the nonjudicially foreclosed deed of trust also secures the guaranty. It is this situation that has the appellate courts coming to completely different conclusions.

In First-Citizens Bank & Trust Co. v. Cornerstone Homes & Development, LLC,[1] Division II found that a commercial guarantor is not liable for a deficiency judgment after a trustee's sale when the nonjudicially foreclosed deed of trust also secured the guaranty. Relying on the language in the antideficiency statute, the court concluded that subsection 10 of the antideficiency statute implicitly prohibits a guarantor's liability for a deficiency when the deed of trust secures the guaranty and has been nonjudicially foreclosed upon. The court went on to reverse a lender's deficiency judgment against guarantors after finding that the nonjudicially foreclosed deeds of trust did in fact secure the guaranty at issue.

A couple of months later, in *Washington Federal v. Gentry,*[2] Division I considered and rejected Division II's interpretation of the antideficiency statute. Division I found that subsection 10 did not prohibit deficiency judgments against guarantors when the nonjudicially foreclosed deed of trust also secured the guaranty. Division I strongly criticized Division II's reasonings, and used completely different statutory construction principles to arrive at its opposite conclusion. In addition to disagreeing with Division II's interpretation of the antideficiency statute, Division I also disagreed with Division II's interpretation of the language found in the deed of trust—Division I concluded that the deeds of trust before it did not secure the guaranties at issue, even when the guarantors argued that the deeds of trust contained similar language as those found in *Cornerstone*. The court of appeals in *Gentry* ultimately reversed the trial court's dismissal of the deficiency action against the guarantors.

Now, not only does Washington have two appellate courts that disagree over the interpretation of the antideficiency statute as it relates to commercial guarantor liability after a trustee's sale, but Washington also has two appellate courts that disagree over the interpretation of common language found in commercial loan documents. And unfortunately, issues surrounding guarantor liability and the interpretation of similar contractual language will continue to surface, since many financial institutions use (or have inherited through an asset purchase from the FDIC) the stock forms that have the potentially problematic language in which the deed of trust arguably secures related guaranties. This is evident by the fact that the above-mentioned cases, which concerned different financial institutions, had deeds of trust with similar language.

We now find ourselves at the mercy of the Washington Supreme Court—waiting for it to provide clarity in the face of uncertainty. And because there is a clear split of opinion between the appellate divisions, the Supreme Court is more likely to accept a petition for review *if* one is filed. But until then, financial institutions should proceed with caution, and make sure to know which appellate opinion governs their actions. My guess is that the next hotly debated issue in this area will be whether a commercial guarantor can waive the statutory protections found in the antideficiency statute.

For further information about loan guarantors' liability, contact Dana Rognier at (206) 622.8484 or at dana.rognier@millernash.com.

[1] 314 P.3d 420 (Wn. Ct. App. 2013).

[2] No. 70004-9-1 (Wn. Ct. App. Feb. 18, 2014).

Why You Need More Than Just a Certificate of Insurance

by Stacey Martinson
stacey.martinson@millernash.com

It is common practice for entities such as owners, contractors, and design professionals to contractually require another party to provide insurance. The most common method of providing information related to this requirement is through a certificate of insurance. A certificate is usually issued on a form copyrighted by an organization named ACORD (Association for Cooperative Operations Research and Development). Other forms can be used, but because the ACORD form is the most commonly used form today, this discussion will focus on the terms of that form of certificate.

Many individuals place too much significance on the certificate and are surprised to learn of its limitations. Here are the top five reasons to not rely on a certificate:

1. Information Only. The most important thing to remember is that a certificate is provided for information purposes only and is not part of the insurance policy. If you look carefully at the most recent ACORD form (Form 25, Certificate of Liability Insurance), you will see that it contains a disclaimer: "This certificate is issued as a matter of information only and confers no rights upon the certificate holder. This certificate does not affirmatively or negatively amend, extend or alter the coverage afforded by the policies below." Practically, then, even though a certificate states that certain insurance coverage exists, this does not mean that it does. Of course, brokers and agents have obligations to fill out certificates with accurate information, but if the information is incorrect, you likely won't be able to rely on a certificate alone for coverage.

2. Additional Insured. Just because the certificate states that you are an additional insured doesn't mean that you are. The only way that a party can be added as an additional insured is by endorsement. Therefore, even if the certificate states that you are an additional insured, you will not be afforded such a status unless the insurance carrier actually endorses the policy. A good business practice is to not rely on the certificate as evidence that you are an additional insured; request an actual copy of the additional-insured endorsement along with the certificate. This will also allow you to verify whether the endorsement matches the contract requirements.

3. Notice of Cancellation. Don't be surprised if you are not provided with notice of a cancellation or nonrenewal. In 2009, ACORD changed its form language to state: "Should any of the above described policies be cancelled before the expiration date thereof, notice will be delivered in accordance with the policy provisions." This statement reaffirms the general rule that an insurance carrier is under no obligation to provide notice unless the terms and conditions of the policy provide for the notice. In addition, notice is usually provided only to "named insureds" and not additional insureds. A good business practice is to specifically include notice requirements in the contract between you and the other party or consider requesting that the policy be endorsed to provide cancellation notices.

4. Differing Contractual Requirements. Many entities receive a certificate and assume that any contractual insurance requirements between the parties have been met. When a broker or agent completes a certificate, however, he or she might not compare the terms of the insurance policy with the contractual insurance requirements between the parties. Be sure to review the certificate against the contractual requirements and request additional evidence or explanation if needed.

5. Snapshot in Time. A certificate is limited to providing information about a policy at a given time. Because it is just a snapshot in time, the certificate will not reflect future changes in the policy, such as added exclusions or reduced coverages. Therefore, it is imperative that the insurance requirements be clearly articulated in the contract between you and the other party to protect your interests. Don't rely on the certificate as proof that insurance coverage will continue and not change.

In sum, a certificate still provides a good starting point for obtaining information about another party's insurance information and should be used. A certificate is especially important in identifying insurance carriers and policy numbers in the event of a claim. But be aware of its limitations and adjust your business practices accordingly. Remember to always review a certificate for any errors or information that conflicts with the contractual requirements.

For further information about certificates of insurance, contact Stacey Martinson at (503) 224.5858 or at stacey.martinson@millernash.com.

Successor Tenant Liable . . . | Continued from page 1

NW and accordingly found Blachana liable to reimburse BOLI for the wages BOLI had paid to NW's former employees. In arriving at its conclusion that Blachana was a successor to NW, BOLI determined that NW and Blachana operated essentially the same business, based on BOLI's evaluation of the following factors: (1) the identity of the business, (2) its location, (3) the lapse of time between the previous operation and the new operation, (4) whether the same or substantially the same workforce was employed, (5) whether the same product was manufactured or the same services were offered, and (6) whether the same machinery, equipment, or methods of production were used.

In its analysis of the six factors, BOLI concluded that all but one of the factors was met. Specifically, BOLI held that the businesses operated under similar names (i.e., identity of business), that the businesses used the same phone number (i.e., identity of business), that the businesses operated in the same location, that less than 50 days had elapsed between the closing of NW's business and the opening of Blachana's business, that both businesses offered the same types of products (food, alcohol, and music), that both businesses used substantially the same equipment, and that both businesses had similar vendors. Although Blachana never employed the same employees as NW, because the other five factors were met, Blachana was held to be liable for payment of wages that NW had failed to pay to its employees.

In the commercial real estate context, this case may cause concern in leasing transactions when a defunct tenant surrenders its space (with or without surrendering its inventory, equipment, and goodwill) and the landlord immediately leases the space to a new tenant for a similar use (e.g., accepting surrender of a space used by Pizza King and immediately leasing it for use by Pizza Queen). Although the landlord wasn't held responsible for the unpaid wages of the prior operator in this case, a landlord often has an interest in helping ensure that its tenant will not be held liable for unpaid wages of a prior tenant because that could negatively impact the tenant's ability to perform under the lease.

In these types of situations, the risk of the new tenant's being held liable for unpaid wages of the prior operator can be reduced by the new tenant's (1) operating the new business under a name that is very different from the name of the prior operator, (2) not using the same phone number as the defunct tenant, and (3) not employing any of the workers of the prior operator. Additionally, in connection with negotiating an early termination of a lease for a defunct tenant, the landlord might want to consider requiring a representation and warranty from the defunct tenant that all employee wages have been and will be timely paid and obtaining contact information for the defunct tenant so that if wages remain unpaid, it will be easier to track down the defunct tenant to try to collect them.

For further information regarding successor tenant liability, contact Jeneé Hilliard at (503) 224-5858 or at jenee.hilliard@millernash.com.

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Critical to the court's analysis was the fact that the contract did not define "completion," so the court turned to the ordinary meaning found in dictionaries. The court observed, "While the term 'completion' does not encompass the incomplete, the definition of 'substantial completion' does," and noted that if the contractor had intended the warranty period to run from the date of substantial completion, it should have made its intention apparent in the construction contract through use of that phrase. The project was not complete until the items on the punch list were complete. Lesson: Be precise concerning when the warranty period begins or ends, and define all key terms in the contract.

Contractors should pay attention to other key provisions in a construction contract, including defining the scope of the construction project, limiting indemnification provisions, and preserving lien rights. We will explore future topics in later editions of *GroundBreaking News*.

For more information about construction contracts, contact LeAnne Bremer at (360) 619-7002 or at leanne.bremer@millernash.com.

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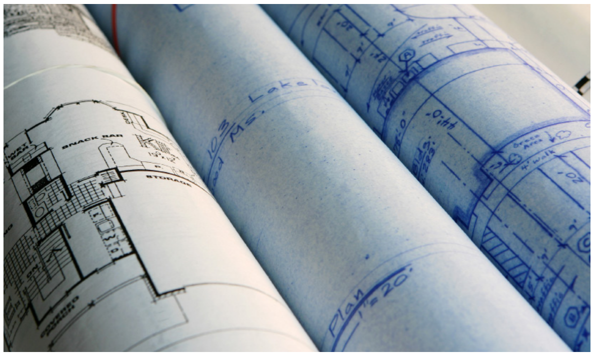

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