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UNDER CONSTRUCTION

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Message From the Editor:

As we find ourselves moving into the age of electronic communication, we can no longer ignore the importance of electronic document retention and its effects on construction contracts and disputes. Regardless of the type of company you own or work for, it is imperative that you understand what this means for the future of your organization.

Likewise, one needs to understand the prevention doctrine and its potential effect on "pay-if paid" and "pay-when-paid" clauses. This prevention doctrine may have an effect on such clauses. The prevention doctrine provides that a party who prevents performance of a contract may not complain of such nonperformance.

Lastly, owners and general contractors have received labor union threats to disrupt construction sites. You should understand that the National Labor Relations Board (NLRB) requires that any warnings or threats directed to neutral employers must include assurances that the picketing will be conducted in a lawful manner.

These above topics, addressed in this newsletter, can serve as a reference to provide awareness of legal updates in the construction industry. Under Construction is provided as a service to highlight legal trends and issues commonly faced. Please contact us if you have any questions or suggestions. Let us know how we can improve this publication to provide even more value to you.

Jim Sienicki is a partner with Snell & Wilmer in Phoenix, Arizona, where he is the head of the firm's construction practice group. His practice has been concentrated on a wide variety of construction matters since 1983. Jim is a member of many construction trade associations and can be reached at 602.382.6351 or jsienicki@swlaw.com.

FACING THE NEW WORLD OF E-DISCOVERY IN CONSTRUCTION DISPUTES

By: Mark Konrad and Chris Breitkreitz

A quick peek in any project trailer today will likely reveal one or more desktop computers through which the job is being managed. A usual construction project typically produces thousands of electronic "documents," including, among other things, e-mails (between project managers, contractors, subcontractors, suppliers, owners, architects, and engineers), contracts, change orders, invoices, cost or pricing information, meeting minutes, weather data, project notes, schedules, drawings and specifications. Not surprisingly, it is on this mountain of electronic documents where an increasing number of construction battles are now being waged, and where the winner (or loser) is often being determined by the e-mails which never quite made their way into the official project file.

As part of this new world, you should also know that the rules of litigation have been changing. For example, effective December 1, 2006, the Federal Rules of Civil Procedure were updated to address the duties of parties to obtain, maintain, and disclose electronic data. See Fed. R. Civ. P. 16, 26, 33, 34, 37, and 45. Following is a quick primer on some of these changes, and some practical thoughts on how to manage your construction dispute in this electronic world.

Among other things, the recent amendments to the Federal Rules provide that a party to litigation must now, without awaiting a discovery request, disclose a copy of, or a description by category and location of, all electronically stored information that is in its possession, custody, or control and that it may use to support its claims or defenses. The Federal Rules also provide that parties to any litigation must address issues relating to the disclosure or discovery of electronically stored information at the beginning of any litigation. Thus, lawyers will now be required to learn about their client's electronic data, discuss it with opposing counsel, and address it with the court at the outset of the litigation.

Furthermore, the Federal Rules now specifically address a party's request regarding how electronically stored information may be produced. Specifically, a request for the production of documents may now specify the format in which electronically stored information is to be produced. If it is cost prohibitive or otherwise burdensome, the responding party may object to the requested form and offer an alternative format through which it intends to produce the electronically stored information. If the parties cannot ultimately agree, the court will intervene to decide the issue.

Turning to discovery abuses, the Federal Rules have always provided that a court may impose sanctions on a party for failing to provide certain information to an opposing party. The rules now provide, however, that absent exceptional circumstances, a court may not impose sanctions on a party for failing to provide electronically stored information if

such information was lost as a result of the routine, good-faith operation of an electronic information system. This being said, depending on the circumstances, "good faith" may require that a party intervene to suspend or modify a system to prevent the loss of electronically stored information if it knows that a dispute has arisen. Accordingly, it is now important not only to know what electronic documents exist, but how computer systems operate to manage such records.

A number of additional suggestions are listed below in order to better prepare construction clients in assisting their attorneys with electronic discovery issues.

- Parties must be aware that, unlike paper documents, e-mail and other forms of electronically stored information are subject to reproduction. Thus, parties must be sensitive to the fact that electronically stored information may be reproduced and stored in a number of forms and locations – all of which may be accessible for production.

- Parties must be aware that electronically stored information is particularly susceptible to destruction (and proof of destruction). For example, businesses and their employees may view deletion of e-mail and other forms of electronically stored information differently than the deletion of a hard file document. This is a dangerous assumption, and can sometimes be used by opposing counsel to challenge credibility where there should be no issue. As a result of the rule changes, you should be aware that the preservation, collection, and production of electronic documents are important issues that cannot be ignored. The use of forensic data recovery (which shows when documents were edited or deleted) is also an important process with which to familiarize yourself.

- Part of the problem with preserving electronically stored information is that there are countless places where electronic data may be stored or maintained: backup tapes, computers and servers upon which electronic mail and data reside, blackberries, voicemail, laptops, personal computers at home, etc. Hence, in order to appropriately satisfy the disclosure rules and respond to discovery requests, attorneys and their clients should become acquainted with the individuals managing the information technology departments in order to fully understand the condition of the client's electronic data system.

- The cost of hard document production, the cost of electronic document production, and the cost of no production should all be considered. Often the last method can be the most costly if a party fails to produce certain electronic documents and the court decides to sanction the party for doing so. Clients should look into and evaluate the possibility of cost shifting or cost sharing with respect to the production or request of electronic documents. The high cost of managing, indexing, and being able to search electronic documents should also be explored.

- Showing good faith will go a long way to avoiding potential electronic discovery sanctions. Steps must be taken to preserve reasonably accessible electronic documents and data as soon as the possibility of litigation arises. Waiting until the service of a complaint or the filing of an answer may be too late. There is always the possibility that costly sanctions

may be imposed if parties do not preserve documents.

- A party should not put off electronic discovery issues to the end of discovery or, even worse, to the eve of trial. One should seriously consider electronic discovery issues at disclosure and discovery conferences.

- Along with the large production of electronic documents, the issue of inadvertently producing privileged documents increases. A party should consider using technology to aid in its review of electronic documents prior to production, as well as consider entering into agreements with the opposing party regarding the inadvertent disclosure of privileged information.

Electronically stored information creates unique discovery and evidentiary challenges. In this new age, attorneys and their clients must expect these challenges and plan for them. Although a construction project might produce thousands of electronic documents, there are methods in which a party can appropriately and effectively work within the new rules. If you have any questions about their electronic discovery issues, you should contact your attorney as soon as practicable in order to develop an electronic information strategy which can best manage the myriad of issues which may now arise.

For more information please contact Mark E. Konrad at 520.882.1220 | mkonrad@swlaw.com or Christopher Breitkreitz at 520.882.1249 | cbreitkreitz@swlaw.com

Mark Konrad's commercial litigation practice has included a substantial amount of advice in the area of construction and procurement. His experience in the arbitration and litigation of construction disputes makes him particularly suited to and valuable in the negotiation of construction contracts. He has had substantial experience with both state and federal construction and procurement requirements.

Christopher Breitkreitz's practice is concentrated in commercial litigation.

THE PREVENTION DOCTRINE AND ITS EFFECT ON "PAY-IF-PAID" AND "PAY-WHEN-PAID" CLAUSES

By: Jim Sienicki and Jennifer Roth (Summer Associate)

The prevention doctrine may have an effect on a carefully drafted "pay-if-paid" or "pay-when-paid" provision – that is, one that attempts to condition and limit a subcontractor's right to receive payment on whether the general contractor has received payment from the owner. Two federal Circuit Courts of Appeals have applied the prevention doctrine to repudiate a "pay-if-

paid" or "pay-when-paid" provision and it is possible the Arizona and other state courts will follow this lead. This article addresses the prevention doctrine and its potential effect on "pay-if-paid" or "pay-when-paid" clauses.

Prevention Doctrine

The prevention doctrine provides that a party who prevents performance of a contract may not complain of such nonperformance. In applying the prevention doctrine, the Arizona courts have noted that the party's conduct must have been unjustified, wrongful and not authorized under the terms of the contract to prevent them from maintaining an action under the contract. In fact, in *Security National Life Insurance Co. v. Pre-Need Camelback Plan, Inc.*, the Arizona Court of Appeals refused to apply the prevention doctrine because the parties did not engage in wrongful conduct.

Effect on Third-Party Payment Provisions

Pay-when-paid clauses and pay-if-paid clauses are often referred to as third-party payment provisions. Pay-when-paid clauses refer to contract language that has been held to merely delay the timing of payment, making payment to a subcontractor due within a reasonable time after the subcontractor completes performance. Conversely, pay-if-paid clauses make payment to a subcontractor contingent upon the owner's payment to the general contractor. Generally, the provision's language explicitly states that the owner's payment to the contractor is a condition precedent to the contractor's payment to the subcontractor.

Once a court interprets a payment provision as a condition precedent, the written agreement generally defeats the subcontractor's claim against the contractor for payment. However, a determination that a payment provision is a condition precedent does not supersede a subcontractor's claim for payment under all circumstances. A subcontractor will be entitled to payment if the general contractor prevents the condition precedent from occurring. This is the essence of the prevention doctrine.

In *Moore Brothers Co. v. Brown & Root, Inc.*, the Fourth Circuit Court of Appeals held that a contractor was unable to rely on a pay-when-paid clause as a defense to its failure to pay because the contractor hindered the fulfillment of a condition precedent. Toll Road Investors Partnership ("TRIP") contracted with Brown & Root for the construction of the Dulles Toll Road extension. Brown & Root then contracted with Moore Brothers & Lane Construction. The subcontract stated that Brown & Root had no obligation to pay Moore Brothers until it received payment from TRIP.

As the construction of the Dulles Toll Road extension progressed, Brown & Root noticed the need for a thicker pavement subbase. Brown & Root, however, assured the lenders financing the highway project that no substantial changes in the work were anticipated. Additionally, Brown & Root removed the design change illustrations from the prime construction contract and placed those illustrations in a side agreement (the existence of which was not revealed to the lenders). Because the lenders were not aware that any additional work was necessary, they did not arrange for additional financing. Thus, TRIP did not have the funds to pay Brown & Root for the additional work, and as a result, Brown & Root claimed that it was not obligated to pay Moore Brothers.

The Fourth Circuit concluded that Brown & Root hindered the fulfillment of the condition precedent. Therefore, the court held that the trial court correctly invoked the prevention doctrine to waive the performance of the condition precedent, making Brown & Root liable to Moore Brothers for payment for the additional work.

In the most recent case applying the prevention doctrine to a third-party payment provision, *Northeast Drilling, Inc. v. Inner Space Services, Inc.*, the Eighth Circuit Court of Appeals similarly held that a subcontractor could not invoke a pay-when-paid clause after it prevented fulfillment of a condition precedent. Because the subcontractor failed to submit a change-order request to the contractor after drilling in an expanded area, it contributed to the contractor's failure to pay. Thus, the subcontractor was required to pay the sub-subcontractor because the prevention doctrine applied and rendered the pay-when-paid clause void.

Although Arizona and other state courts have yet to apply the prevention doctrine to third-party payment provisions, other courts provide guidance on the issue. Because there is no case law holding otherwise, Arizona and other state courts will likely invoke the prevention doctrine to waive performance of a condition precedent if the contractor hinders performance.

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LABOR UNIONS' THREATS TO DISRUPT CONSTRUCTION SITES

By: Jerry Morales

Owners and general contractors have been receiving letters from construction trade unions which, in essence, inform them of the union's labor dispute with one or more of the contractors working at their jobsites, and of "the public information campaign" which the union intends to conduct. Typically, these letters state:

It has come to our attention that XYZ, Inc., is or will be working at your project. Please be informed that this union has an ongoing labor dispute with XYZ, Inc. We want you to be aware of our aggressive public information campaign against XYZ, Inc. This campaign may include picketing, highly visible banner displays, distribution of handbills, and demonstrations at the construction jobsite . . .

In these letters, employers, such as the owner and the general contractor, with whom the union does not have a labor dispute are the "neutral employers." Employer(s) with whom the union does have a labor dispute, such XYZ, Inc., in the above scenario, are considered the "primary" employers(s).

Under current NLRB law, a letter such as the one above would be unlawful, because it uses the term "picketing" without qualification. It is well established that a union may picket against an employer at a construction site where other

employers also perform work (common situs) if:

a. The primary employer is present at the site during the picketing;

b. The primary employer is engaged in its normal business at the site;

c. The picketing occurs reasonably close to the location where the primary employer works at the site (reserved gates); and

d. The picket signs identify the primary employer.[1]

The NLRB requires that any warnings or threats directed to neutral employers that the union plans to picket a construction jobsite must include assurances that the picketing will be conducted in a lawful manner.[2]

If the union's letter to the neutrals does not specifically refer to "picketing," as part of the "public information campaign," the letter, by itself, is not unlawful. The NLRB takes the position that threats to engage in bannering, handbilling, or other demonstrations "do not constitute threats to engage in unlawful confrontational conduct."[3]

The NLRB and the courts scrutinize bannering, handbilling, or other demonstrations to determine whether, under the totality of the circumstances, "confrontational activity" occurs. If it is determined that, under the circumstances, the activity is "confrontational," the NLRB may prosecute the union's conduct as violating the prohibition against secondary boycotts.

In order to prevent costly disruptions at the construction site, labor counsel should be consulted as soon as there is information that a union may have a labor dispute with one of the contractors performing services at the site. At Snell & Wilmer, we have the resources to assist owners and contractors at construction jobsites to prevent and minimize disruptions arising from labor disputes.

For more information please contact Jerry Morales at 602.382.6362 | jmorales@swlaw.com

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1 *Moore Dry Dock*, 92 NLRB 547 (1950).
2 *Young Plumbing*, 227 NLRB 300, 312 (1976) (generalized threat to picket common situs is unlawful, as it does not carry a presumption that the picketing would conform to established restrictions.
3 Mountain West Regional Council of Carpenters. NLRB ADVICE MEMORANDUM, Dec. 18, 2002.

Gerard Morales is a partner in our Phoenix office. Jerry's labor/employment and construction law experience includes representation in employment related matters, including wrongful termination, employment discrimination, arbitration and other alternative dispute resolution proceedings; extensive experience in NLRB unfair labor practice trials, and union elections matters, collective bargaining, labor law issues affecting the construction industry, wage and hour compliance, corporate policy development, and administrative proceedings before state and federal regulatory agencies, including the Equal Employment Opportunity Commission, U.S. Department of Labor, and National Labor Relations Board. Jerry's employee benefits law experience includes representation with respect to collectively-bargained employee benefit funds and withdrawal liability claims.

AMERICAN INSTITUTE OF ARCHITECTS (AIA) DOCUMENT UPDATE SEMINARS

Join Snell & Wilmer construction attorneys as we interpret the recently released AIA documents and help industry professionals fully understand the impact these changes have on their respective business operations. December 4, 2007, 7:00 a.m., Snell & Wilmer, One Arizona Center 400 E Van Buren, Phoenix, AZ 85004-2202. Please RSVP to rsvp@swlaw.com | 602.382.6599 by November 27, 2007.

Join Leon Mead, Jason Ebe and other Snell & Wilmer attorneys as they discuss and interpret the latest AIA documents and help industry professionals fully understand the impact these changes have on their respective business operations. December 4, 2007, 11:30 a.m. – 1:00 p.m., Snell & Wilmer, 3883 Howard Hughes Parkway, Suite 1100, Las Vegas, NV, 89169. Please RSVP to Katy Ramsey | 702.784.5200 by November 27, 2007.

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