CONSTRUCTION CITE

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NEW CONSTRUCTION

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When Is Work Product Not?

John Spangler and Deborah Cazan

Introduction

Construction disputes present complex issues of causation—what caused the accident, the delay or the added costs. Third-party consultants are frequently engaged to evaluate and offer opinions on causation, performance, schedules and costs. Then, when the dispute or accident ends up in litigation, the materials prepared by the consultants are sought in discovery. Claims of work product are often asserted, raising the question of what is covered by the work-product doctrine and what is not.

A common misconception is that if the consultant generating the materials is engaged by an attorney, the materials prepared by the consultant are automatically shielded from discovery. That is not the case. The work-product doctrine shields documents from discovery if they were prepared in anticipation of litigation, but not if they were prepared in the ordinary course of business.

Tough questions arise when one party claims that a document or report was prepared in anticipation of litigation, while the other party contends it was prepared in the ordinary course of business. Even more difficult are documents that are prepared for a dual purpose—i.e., in the ordinary course of business, but also in anticipation of litigation. Understanding how the doctrine is applied in these contexts is essential to protect documents from unwarranted discovery and preclude the improper invocation of the work-product doctrine to withhold documents that should be produced.

The Work-Product Doctrine—What Is It?

The work-product doctrine is a judge-created doctrine, and as initially crafted, protected from discovery written statements, private memoranda and personal recollections prepared by an attorney in anticipation of litigation.[1] The intention was to create a zone of privacy around the attorney so as to allow the preparation and development of legal theories and strategies with an eye toward litigation, free from unnecessary intrusion by his adversaries.[2]

The doctrine is now codified in the Federal Rules of Civil Procedure (and in similar state procedure rules) and extends far beyond just the thought processes of an attorney. The work-product doctrine now encompasses "documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative,"[3] and a party's representative can be its attorney, but it also can be its insurer, employee or other agent. The doctrine applies so long as the party or its representative, working on behalf of the party, prepared the document or other written materials with the prospect of litigation in mind.

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[1] The Supreme Court created this limited protection in *Hickman v. Taylor,* 329 U.S. 495, 67 S. Ct. 385, 91 L. Ed. 451 (1947).

[2] *United States v. Adlman,* 134 F.3d 1194, 1196 (2d Cir.1998); S.E.C., v. NIR Grp. LLC, 283 F.R.D. 127, 131 (E.D.N.Y. 2012).

[3] Fed. R. Civ. P. 26(b)(3)(A).

Unlike the attorney-client privilege, which shields from discovery confidential communications between clients and their attorneys,[4] the work-product doctrine is not absolute, and can be overcome if the party seeking the documents can show it has a substantial need for the materials to prepare its case for trial and cannot, without undue hardship, obtain their substantial equivalent.[5] It is also important to recognize that the party claiming work product, and seeking to prevent the discovery of the documents or materials, bears the burden of proof, and must demonstrate to the court that the materials were in fact prepared in anticipation of litigation and that the work-product doctrine applies.[6]

The "Because-Of" Test

Documents must be prepared "in anticipation of litigation" in order for the work-product doctrine to apply. In deciding where to draw the line between documents generated in the ordinary course of business—and thus not subject to the work-product doctrine—and those prepared in anticipation of litigation, most courts apply the "because-of" test, and ask the question, "Was the document created because of anticipated litigation?"[7]

In the construction context, the "because-of" test is frequently applied when reports and other internal documents are prepared by insurers and sureties, and then sought in subsequent litigation. Both insurers and sureties are in the business of evaluating risks, and both prepare reports and other internal documents evaluating those risks as part of their ongoing business operations. They also frequently litigate claims, so it is not always clear when documents are prepared for a business purpose versus a claim or litigation purpose.[8]

Two cases out of New York illustrate this issue. In *Safeco Ins. Co. v. M.E.S., Inc.*,[9] the surety brought an action against the principals on several bonds the surety had issued, seeking contractual indemnity for losses the surety alleged it would incur due to the principals' defaults on several construction projects.

Safeco had engaged consultants to evaluate the contractors' performance on the projects before the defaults occurred, and the consultants issued Safeco reports of their findings. Safeco claimed the reports were protected from discovery by the work-product doctrine, arguing that they were generated in anticipation of claims arising out of the projects. The contractors argued that Safeco would have performed the same investigation of the underlying projects irrespective of whether litigation was anticipated, thus making the reports fully discoverable.

Safeco's claim of work product was rejected and the documents ordered produced because Safeco failed to convince the court that the same analysis performed by the consultants would not have been undertaken in the ordinary course of its business, which includes, among other things, the evaluation of risks. The court was also influenced by the fact that the consultants had been hired by Safeco to provide construction management advice to Safeco before the default occurred, further blurring the line between services obtained in the ordinary course of business and those obtained in anticipation of litigation.

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[4] *Shipes v. BIC Corp.,* 154 F.R.D. 301, 304 (M.D.Ga.,1994).

[5] Fed. R. Civ. P. 26(b)(3)(A).

[6] *In re Grand Jury Subpoenas Dated Mar. 19, 2002* & Aug. 2, 2002, 318 F.3d 379, 384 (2d Cir. 2003); *William A. Gross Constr., Assoc., Inc. v. Am. Mfrs. Mut. Ins. Co.,* 262 F.R.D. 354 (S.D.N.Y. 2009).

[7] *Adlman*, 134 F.3d at 1195; *In re Grand Jury Subpoena (Mark Torf/Torf Envtl. Mgmt.),* 357 F.3d 900, 907 (9th Cir. 2004); *Cal. Earthquake Auth. v. Metro. West Sec., LLC,* No. 2:10-CV-291, 2012 WL 3150263, at *4 (E.D. Cal. Aug. 1, 2012); *Cleveland Clinic Health Sys. v. Innovative Placements, Inc.,* 283 F.R.D. 362, 369 (N.D. Ohio 2012).

[8] *Travelers Cas. & Surety Co. v. J.D. Elliott & Co.,* No. 03-CIV-9720, 2004 WL 2339549 at *2 (S.D.N.Y. Oct. 5, 2004) (there is no "bright-line" test for determining when an insurance company's investigative work passes from work in the ordinary course of the insurance company's business to work performed in anticipation of litigation).

[9] *Safeco Ins. Co. of Am. v. M.E.S., Inc.,* No. 09-CV-3312, 2011 WL 6102014 (E.D.N.Y. Dec. 7, 2011).

In contrast, in *William A. Gross Construction Associates, Inc. v. American Manufacturers Mutual Insurance Co.*,[10] the court upheld a work-product claim as to preliminary evaluation reports prepared for the owner by its consultant, Hill International. Hill prepared the reports at the request of the owner's counsel, and at the time they were prepared, the owner was facing claims from its contractors totaling $72 million. Hill also was engaged to perform the analysis at a time when the owner's counsel thought litigation was imminent, and in fact, litigation commenced about two months after Hill was hired.

Although Hill was also providing construction management services to the owner on the project, the owner's counsel hired a separate group at Hill to perform the claim evaluations and the claim consultants were not involved with the construction management work Hill performed. The claim consultants also had no contact with the contractors on site. Also, unlike the continuous involvement of the Hill personnel providing construction management services, the claim consultants were involved in a short-term assignment that was scheduled to end about three weeks before the litigation commenced. In addition, the report prepared by the claim consultants discussed possible litigation positions and provided a litigation analysis of certain documents. Taken together, these facts established that the claim reports were protected work product created in anticipation of litigation, and not in the ordinary course of business.

Construction accident reports are treated in the same fashion as is illustrated in *Alta Refrigeration, Inc. v. AmeriCold Logistics, LLC.*[11] In this action, the court rejected the claim that an accident investigative report, prepared in accordance with the company's incident investigation policy and to comply with certain OSHA regulations, was protected from discovery by the work-product doctrine. Since the company had a business policy to create such reports, it could not demonstrate the report was prepared in anticipation of litigation, and could not invoke the work-product doctrine to shield the report from production.

Dual-Purpose Documents

Another tough issue is presented by dual-purpose documents — documents created for both a business reason and in anticipation of litigation. Work-product protection will not be afforded the document if it would have been prepared in substantially similar form or content irrespective of the expected or anticipated litigation. The pertinent question is what would have happened had there been no litigation threat—that is, would the party seeking work-product protection have generated the document if it were acting solely for a business-related purpose?[12] To answer this inquiry, courts focus on the form, or content of the document and ask whether the document would have been prepared in substantially similar form but for the prospect of litigation. If this showing can be made, the privilege applies, but if the document would have been prepared in the same form regardless of the threat of litigation, the document goes unprotected.[13]

Typical of this type of situation is the report commissioned in *United States v. Adlman.*[14] In this case, an accountant and lawyer at Arthur Anderson were engaged to evaluate the tax implications of a proposed merger. The Anderson consultant prepared a memorandum to assist the client with the proposed merger — a business decision, but also for litigation purposes—because it was certain the tax advantages the client intended to claim from the proposed transaction would be challenged by the Internal Revenue Service. The Anderson memorandum contained a detailed legal analysis of likely IRS challenges to the transaction, proposed legal theories or strategies to address the expected challenge and predictions about the likely outcome of litigating with the IRS.

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[10] *William A. Gross Constr., Assoc., Inc. v. Am. Mfrs. Mut. Ins. Co.,* 262 F.R.D. 354 (S.D.N.Y. 2009).

[11] *Alta Refrigeration, Inc. v. AmeriCold Logistics, LLC,* 301 Ga. App. 738, 688 S.E.2d 658 (2009).

[12] *Allied Irish Banks v. Bank of Am., N.A.,* 240 F.R.D. 96, 106 (S.D.N.Y. 2007).

[13] *Adlman,* 134 F.3d at 1195; *In re Grand Jury Subpoena (Mark Torf/Torf Envtl Mgmt.),* 357 F.3d 900, 907 (9th Cir. 2004); *Cal. Earthquake Auth. v. Metro. West Sec., LLC,* No. 2:10-CV-291, 2012 WL 3150263, at *4 (E.D. Cal. Aug. 1, 2012); *Cleveland Clinic Health Sys. v. Innovative Placements, Inc.,* 283 F.R.D. 362, 369 (N.D. Ohio 2012).

[14] 134 F.3d 1194 (2d Cir.1998).

Looking at the totality of the situation, the court concluded that a dual-purpose document could nevertheless be subject to work-product protection if the document was created in anticipation of litigation and would not have been created in substantially similar form, but for the prospect of litigation.[15]

A case applying the dual-purpose test in the construction context is *G.M. Harston Construction. Co. v. City of Chicago,* a case arising out of Chicago's[16] termination of a construction contract for convenience. Under the terminated contact, the city was contractually required to work with the terminated contractors to determine the amounts they were owed for work performed prior to the termination.

To facilitate the performance of this contractual obligation, the city engaged Deloitte & Touche, an independent auditing firm, and advised the terminated contractors that Deloitte would evaluate their termination claims. Thereafter, the terminated firms supplied financial information to Deloitte and met with representatives of the auditing firm several times during their ongoing review of the cost information.

In subsequent litigation, the terminated firms sought discovery of the materials developed by Deloitte when evaluating their claims. The city claimed the materials were protected from discovery by the work-product doctrine, arguing that Deloitte was retained by the city's counsel and in anticipation of litigation. The terminated contractors claimed the city had a contractual duty to evaluate their claims and hired Deloitte to perform or discharge that contractual obligation.

In resolving these competing claims, the court applied the dual-purpose test. The evaluation performed by Deloitte served a dual purpose — to determine what the city owed the terminated contractors under the contracts, and to assess the strength of whatever litigation position the city might take.[17]

Although documents prepared for a dual purpose do not necessarily forfeit work-product protection, the work-product protection did not apply here since the evaluation performed by Deloitte had to be made under the terminated contracts, and in that sense, was performed in the ordinary course of business. Since the city was contractually obligated to evaluate the termination claims, the court concluded that the Deloitte documents would have been created in essentially similar form irrespective of the threat of litigation, and were not protected from discovery.

Conclusion

The work-product doctrine is not a bright-line test that can easily be applied and depends upon the facts and circumstances surrounding the preparation of the requested documents. The party claiming work product has the burden of proof and will be required to produce the documents unless it can carry that burden and convince the court that the documents were prepared in anticipation of litigation, and not in the ordinary course of business. The fact that an attorney engages the consultant or accountant that prepares the subject documents does not automatically shield the materials from discovery. Focus on the question of whether it can be shown or demonstrated that the document was prepared because of the threat of litigation. If this is likely to be a close question, consider hiring a consultant to perform the ordinary course evaluation, and another consultant to assist in litigation planning or analysis.

Also, realize that if the subject document serves a dual purpose — a business purpose and a litigation purpose — the claim of work product will receive greater scrutiny and will necessitate a showing that the document would not have been prepared in its form or would not have contained its content, but for the expected litigation.

Knowing where these lines are drawn and how the doctrine applies is essential to preserve appropriate work product from discovery and prevent improper claim of work product to frustrate appropriate discovery.

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[15] *Adlman*, 134 F.3d at 1201-03. See also, *In re Grand Jury Subpoena (Mark Torf/Torf Envtl Mgmt.),* 357 F.3d at 907; *In re Special Sept. 1978 Grand Jury,* 640 F. 2d 49 (7th Cir. 1980).

[16] *G.M. Harston Constr. Co., v. City of Chicago,* No. 01-C-268, 2001 WL 817855 (N.D. Ill. July 19, 2001).

[17] *G.M. Harston Constr. Co.,* 2001 WL 817855 at *2.

BACK TO ARTICLE LISTING

UNDER CONSTRUCTION

SUMMARIES OF RECENT DECISIONS FROM AROUND THE COUNTRY

West (ID): Oral Agreements Result in Future "He Said/She Said"

Contractors expect lien waivers to be submitted over the course of a construction project. Most states have standard forms that can be used to ensure these agreements are properly recognized in court. A recent federal case discussed the effect of leaving portions of a lien waiver blank, ostensibly to carry out the intent of an oral agreement.

In J. H. Landworks, LLC v. T. Lariviere Equipment & Excavation, Inc., a subcontractor was approached to complete the replacement of several bridges that were located within the boundary of a national forest. The general contractor had an agreement with the United States Forest Service for the scope of work, and then negotiated orally with the subcontractor for a fixed price contract of $190,000, with approximately $30,000 of that total allotted for material costs. Those material costs were to be paid directly by the contractor, but the contractor eventually requested that the subcontractor pay the material costs directly. Upon achieving substantial completion, the contractor asserted that it had not been paid by the Forest Service, but that it would make a payment of $100,000 to the subcontractor, which the subcontractor accepted.

The parties disputed whether there were subsequent conversations about the balance payment but agreed that a check was delivered to the subcontractor from the contractor for $100,000 and an Interim Claim/Lien Waiver form was also delivered. The subcontractor contended that it left the payment line blank because he intended the release to apply only to the $100,000 actually received and not the balance. The contractor argued that the subcontractor's representative picked up the waiver form from the contractor's administrative staff, was told the $100,000 check was intended as final payment, and that while the subcontractor brought back the waiver notarized and signed, at that time the contractor's administrative staff wrote in the amount of $100,000 in the presence of the subcontractor himself before giving the subcontractor the check. Both agree that the check was accepted and deposited.

When the project was complete, the subcontractor attempted to obtain payment of the contract balance. The United States District Court for the District of Idaho found that a jury would need to determine what the actual agreement between the contractor and subcontractor had been, and that because the lien waiver amount was a material term that was left blank, there were issues of fact sufficient to raise doubt as to what the lien waivers actually established.

While interim arrangements are commonplace on construction projects, it is essential that those agreements be memorialized in writing. Parties often believe that their oral agreements are abundantly simple and straightforward, only for the terms to "change" over time. Allowing ambiguity with respect to payment terms could result in the entire agreement being altered from what the parties contemplated.

J. H. Landworks, LLC v. T. Lariviere Equipment & Excavation, Inc., No. 2:11-CV-00488-MHW, 2012 WL 4758079 (D. Idaho, Oct. 5, 2012).

Southeast (AR): Profits and Unused Material May Not Be Secured by a Lien

Liens disputes often concern what work may be included in the value of a mechanic's lien. In a recent case in Arkansas, property owners argued that parts of a lien were unenforceable because it included profits and unincorporated materials.

The project involved designing and building an addition to a hospital, and when the contractors and owners disagreed about which party was at fault for problems that arose during construction, the owner stopped paying the contractors and the contractors stopped working on the project, leaving unused materials onsite. Thereafter, the contractors filed a lawsuit asking for several remedies, including lien foreclosure.

BACK TO ARTICLE LISTING

The district court considered (1) whether a lien on a fixed-price contract may include payment for profits where the project had not been completed; and (2) whether the value of a lien may include materials that were not actually incorporated into the project. With respect to profits, the district court held that profits could not be included because lien-able profits contemplate contractors getting the final price on a completed job, not about how much of its contract amount was for profits on an uncompleted job. So, the court rationalized that until the project is completed, profits and losses are irrelevant.

As to materials, the district court interpreted an Arkansas statute on mechanics' liens to give liens to those who supply material *in construction or repair of an improvement to real estate*. The court rationalized that storing materials *near* the construction did not count as being *in construction*. Therefore, the district court concluded that a lien could only lie on the improvement resulting from the actual materials used, and the materials not included in the hospital improvement were not to be included in the contractors' lien.

While this opinion relied heavily on Arkansas law, it highlights the fine line between what values may be secured by a lien and what may not. This is particularly difficult to establish in a lump-sum arrangement such as the one at issue.

Erdman Co. v. Phoenix Land & Acquisition, LLC, No. 2:10-CV-2045, 2012 U.S. Dist. LEXIS 125018 (W.D. Ark. Sept. 4, 2012).

Midwest (OH): Failure to Comply with Contract Requirements for Notice of a Claim May Bar a Breach of Contract Claim.

Construction contracts typically contain various notice requirements in order for a contractor to initiate a claim. For a claim to survive, many jurisdictions require strict adherence to these provisions. For example, a recent Ohio case found that even though a contractor submitted a claim, it did not adhere to specific contractual provisions and the claim was defeated.

Northern Valley Contractors, Inc. and Ohio School Facilities Commission contracted for work at one of the owner's schools. The contractor had a surety issue performance and payment bonds for the project, and the surety became the assignee of the contractor and filed a complaint against the owner asserting various claims, including breach of contract. The breach of contract claim sought damages as a result of the acceleration and compression of the construction schedule and for the owner's failure to remit the remaining contract balance. The owner asserted the surety and the contractor were barred from pursuing the breach of contract claim because they failed to file a claim pursuant to the dispute resolution procedure set forth in Article 8 of the construction contract.

Article 8 required notice of all claims made in writing to the construction manager not more than ten days after the claim occurred; that all claims be certified; and for a written recommendation from the construction manager after a job site dispute resolution process defined in the contract. The trial court ruled that although the contractor had complied with the ten-day notice provision in Article 8 with respect to their claim, the contractor had not subsequently filed a written claim as required by contract and granted summary judgment to the owner.

The appellate court held that the contractor only provided notice of the potential of a claim, not a final claim. Further, the contractor did not supply a certificate as required by the contract. Therefore, the contractor waived its claim.

It is important to get a good understanding of a contract's notice provisions early on during a project because notices can sometimes be rushed to comply with timing deadlines. Further, when preparing a notice, it is essential to go through the provisions again to make sure every requirement is met.

Ohio Farmers Ins. Co. v. Ohio Sch. Facilities Comm'n, 2012 Ohio 951, 2012 Ohio App. LEXIS 856 (10th App. Dist., Franklin Co. March 6, 2012).

BACK TO ARTICLE LISTING

Southeast (TX): Objecting to an Arbitrator's Jurisdiction to Decide a Claim

Mandatory binding arbitration provisions are commonplace in construction contracts. Many provisions contain specific requirements, such as the parties agreeing to use a specific entity (like the American Arbitrations Association), the use of a specific number of arbitrators (typically one or three) and/or the distinction of what specific claims the arbitrator is allowed to decide (some provisions exclude fraud and other claims). All of these issues deal with an arbitrator's jurisdiction to decide a claim.

A recent Texas case discussed the timing associated with objecting to an arbitrator's jurisdiction to decide a claim. An owner approached a contractor about building an apartment structure and the owner and contractor signed a construction contract for the proposed apartment building. The owner was unable to obtain financing for the project himself, so the contractor told him that it would obtain the financing. Subsequently, the contractor had the owner sign a contract for the sale of the property to the contractor, with the owner believing that it was necessary to obtain the financing to build the project, and not realizing that he was transferring title of the property to the contractor. The contractor then notified the owner that it intended to evict the owner from the property. The owner sued the contractor for fraud and the contractor filed a motion to compel arbitration, which the trial court granted. The arbitrator issued an award in the owner's favor for $136,410. The owner moved to enter judgment based on the arbitrator's award and the contractor moved to vacate the award. The trial court entered a judgment confirming the arbitrator's award and the contractor appealed.

The contractor argued that the arbitrator exceeded his powers, which were statutory grounds for vacation of his arbitration award. Specifically, the contractor contended that the arbitrator exceeded his powers because the arbitration agreement required that all disputes were to be resolved by binding arbitration in accordance with the rules of the American Arbitration Association, and the arbitrator was not selected in accordance with those rules. Instead, the contractor complained that the parties were ordered to binding arbitration at the Harris County Disputes Resolution Center, which unilaterally selected the arbitrator without providing a selection process. However, the record showed that the contractor did not object to the method of appointing the arbitrator until after the arbitration was completed. In fact, the contractor did not complain about the method for appointing the arbitrator until he filed a motion for new trial after the trial court had already confirmed the award. The American Arbitration Association rules provided that a party needed to object to the jurisdiction of the arbitrator in a timely manner. Thus, the Appellate Court held that the contractor's right to complain about the method by which the arbitrator was selected was waived.

Many mandatory binding arbitration provisions, and state arbitration codes, define not only the jurisdiction of an arbitrator, but deadlines for when challenges to jurisdiction must be made. It is important to understand these requirements at the onset of litigation so that a timely objection can be made if the agreed upon arbitration rules are not being adhered to. Failure to do so could result in an arbitration proceeding not contemplated by the parties in their contract, and an inability to challenge the results.

Ouzenne v. Haynes, 2012 Tex. App. LEXIS 2888 (Tex. App. Houston 1st Dist. Apr. 12, 2012).

South (GA): Vendors Who Performed Own Home Repairs Were Not Builder/Sellers to Whom Exception to the Rule of Caveat Emptor Applies

In Georgia, the long-standing rule in real estate purchases is caveat emptor ("let the buyer beware"). There is one exception: a negligence action against a builder/seller. A builder/seller may be held liable in negligence where a dwelling is sold containing latent defects that the builder in the exercise of ordinary care knew or should have known and that the buyer could not have discovered in the exercise of ordinary care. Georgia courts have not previously addressed whether this exception applies to an ordinary seller of real estate who performs its own repairs on the dwelling (i.e., whether an ordinary seller who performs repairs is a builder/seller under the exception to caveat emptor).

That was the question (among others) before the Georgia Court of Appeals in *Reininger v. O'Neill*. In this case, the purchasers of a home brought an action against the sellers of that home alleging that the sellers negligently repaired a previous basement water leak. The purchasers contracted with the sellers to purchase the 16-year-old home, which had no previous owners other than the sellers. Prior to this time, the sellers, in an effort to abate water entry into the basement, performed various repairs. The purchase and sales agreement contained an "As-Is Clause," a Merger Clause, and a Property Disclosure Statement on which the sellers had checked "yes" to a question regarding water leakage in the basement, but provided no further written explanation though the sellers had verbally disclosed a water pipe leak in the basement. After closing, the buyers notified the sellers that the home was damaged and then filed suit against the sellers. The trial court determined that the buyers' negligent repair claim failed as a matter of law because the sellers were not considered builder/sellers and thus, the rule of caveat emptor applied without exception.

On appeal, the buyers argued that the rule of caveat emptor did not apply, because the sellers had performed their own repairs rather than hiring a company to perform the repairs. The court affirmed the trial court's ruling, holding that despite performing their own repairs, the sellers still were not considered builder/sellers.

This case helps resolve any question of whether a homeowner should be wary of performing its own repairs, thereby possibly waiving the general rule of caveat emptor in future sales of the home. Homeowners can continue to perform their own repairs without worry. The builder/seller exception only applies to true builders who then sell their own constructed homes.

Reininger v. O'Neill, 729 S.E.2d 587 (Ga. Ct. App. 2012).

South (SC): Federal Arbitration Act Provision in Agreement Found Unenforceable Because Agreement Involved Intrastate Commerce

The Federal Arbitration Act (FAA) evidences a congressional policy to encourage arbitration, and although parties are free to agree that state arbitration law applies, the state law may be pre-empted by the FAA if the transaction involves interstate commerce. In this case, the issue presented was whether an agreement to purchase real estate was a transaction in interstate commerce, and thus implicating the FAA, or one involving purely intrastate commerce. South Carolina courts had not previously addressed this issue presenting a case of first impression. In this case, two parties entered into a Home Purchase Agreement, which contained a Mandatory Binding Arbitration provision stating that all disputes should be resolved by arbitration. The purchaser initiated a lawsuit against the seller alleging numerous construction defects in the dwelling and contending that the arbitration clause was unenforceable under the South Carolina Arbitration Act because the arbitration clause was not on the first page of the Agreement and not identified by capital letters and underlining, all of which are required under the South Carolina Act. The seller contended that the arbitration clause complied with South Carolina law, and thus was enforceable, and alternatively that the arbitration provision was enforceable under the FAA because the sales transaction involved interstate commerce. The seller argued that the sales agreement involved interstate commerce because although it was entered in South Carolina: 1) it required the seller to obtain a warranty from a company in Georgia and to submit any claims to that company in Georgia; 2) the home mortgage was financed by a North Carolina branch of a bank; and 3) the contractor used subcontractors, materials and suppliers from outside of South Carolina. The lower court found the arbitration provision in the Agreement did not comply with the South Carolina Arbitration Act, and also found that the agreement was not subject to the FAA, as the seller did not sufficiently demonstrate that the transaction involved interstate commerce.

On appeal, the South Carolina Supreme Court examined whether the contact with other states was sufficient to qualify as interstate commerce, thereby triggering the application of the FAA. The court first pointed out that courts have traditionally held that real estate transactions are inherently intrastate transactions, and then it looked to courts in other states for guidance, finding that the rule tended to be that "[n]otwithstanding its congenial effects of interstate commerce, the sale of residential real estate is inherently intrastate. Contracts strictly for the sale of residential real estate focus entirely on a commodity—the land—which is firmly planted in one particular state." Applying these principles, the court held that the lower court correctly determined the agreement was not subject to the FAA, as the agreement did not sufficiently involve interstate commerce.

BACK TO ARTICLE LISTING

In most transactions, interstate commerce will be implicated and the FAA will apply. Residential real estate transactions are the exception, and, as the court found here, may be nothing more than a purely intrastate transaction. This case turned on the wording of the arbitration provisions, and its failure to comply with South Carolina's arbitration act. The FAA was not available to save the arbitration provision since the transaction was not in interstate commerce, and the FAA did not pre-empt the state act.

Bradley v. Brentwood Homes, Inc., 730 S.E.2d 312 (S.C. 2012)

BACK TO ARTICLE LISTING

OTHER CONSTRUCTIVE THOUGHTS

UPCOMING SPEAKING ENGAGEMENTS AND PUBLICATIONS OF ALSTON & BIRD'S CONSTRUCTION GROUP

- Kevin Collins and Mark Johnson hosted a seminar in Los Angeles on significant changes to California's laws governing mechanic's liens and related remedies that became effective on July 1, 2012. The program discussed how these important changes will affect construction industry professionals.

- Jeff Belkin and two colleagues, including regulatory counsel for UPS and an assistant U.S. attorney, spoke at the Society for Corporate Compliance and Ethics' (SCCE) 11th Annual Compliance & Ethics Institute in Las Vegas on the anatomy of a government investigation from inside counsel, outside counsel and government attorneys.

- Andy Howard spoke on the topic of conducting business across state lines at the ABA Forum on the Construction Industry's fall meeting on October 18 and 19 in Boston.

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