Oregon State Bar

Construction Law Newsletter

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SUBPOENA LIMITED: THIRD PARTY DISCOVERY IN FEDERAL ARBITRATION ACT ARBITRATIONS

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While private arbitrations are advertised as a way for clients to reduce litigation costs and narrow discovery, most arbitrators and litigators assume that the discovery processes and procedures that are available in a court action are also generally available in an arbitration. However, a number of courts have held that arbitrations subject to the Federal Arbitration Act do not have unfettered discovery with regards to third parties.

As every first-year law student knows, in a court action, the parties can request subpoenas for the documents and deposition testimony of non-parties. These subpoenas are based on the jurisdictional authority of the court. If a non-party is outside of the court's jurisdiction, then the requesting party must apply for a foreign subpoena, which is issued by a court that does have jurisdiction over the non-party.

Alix

Arbitrations are different in that the authority of the arbitrators is based on the consent of the participating parties. The arbitrators have no inherent authority granted by the state. However, Congress recognized the benefits of arbitrations when it enacted the Federal Arbitration Act ("FAA"), which provides a legal framework for binding arbitrations and for recognition of arbitral

awards. Parties can either affirmatively select the FFA to apply, or it can apply by default. To apply by default, the underlying transaction must involve interstate commerce as defined by the Commerce Clause in the U.S. Constitution.

The FAA specifically provides for the participation of third parties within arbitrations, providing at 9 U.S.C. § 7 as follows:

> The arbitrators selected either as prescribed in this title or otherwise, or a majority of them, may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case. … Said summons shall issue in the name of the arbitrator or arbitrators, or a majority of them, and shall be signed by the arbitrators, or a majority of them, and shall be directed to the said person and shall be served in the same manner as subpoenas to appear and testify before the court; if any person or persons so summoned to testify shall refuse to neglect to obey said summons, upon petition the United States district court for the district in which such arbitrators, or a majority of them, are sitting may compel the attendance of such person or persons before said arbitrator or arbitrators, or punish said person or persons for contempt in the same manner provided by law for securing the attendance of witnesses or their punishment for neglect or refusal to attend in the courts of the United States.

At first glance, it appears as if the parties could subpoena third parties to provide either documents or depositions. However, several circuits, including the Ninth Circuit, have held this is not the case.

In *CVS Health Corporation v. Vividus, LLC*, the Ninth Circuit held that arbitrators subject to the Federal Arbitration Act do not have the authority to subpoena third parties to provide documents outside of hearings where the arbitrators are present. 878 F3d 703, 707-708 (2017). Specifically, the Ninth Circuit held "an arbitrator's power under section 7 extends only to documentary evidence 'which may be deemed material as evidence in the case,' further demonstrating that under the FAA an arbitrator is not necessarily vested with the full range of discovery powers that courts possess. Given the clear statutory language, we reject the proposition that section 7 grants arbitrators implicit powers to order document discovery from third parties prior to a hearing." *Id*. at 708. While the Ninth Circuit's ruling was limited to document discovery, other circuits have held that a similar analysis applies to depositions of third parties. *COMSAT Corp. v. Nat'l Sci. Found.*, 190 F3d 269, 275 (4th Cir. 1999).

The uniqueness of 9 U.S.C. § 7 requires some creative thinking if the parties require third-party discovery. First, determine the relative importance of third-party discovery during contract negotiations. For some contracts, access to information from third parties and subtier suppliers can be vital. If a dispute arises, lack of third-party cooperation could be a serious hindrance to the case. Where these concerns exist, selection of a state arbitration act to govern disputes may provide an avenue to third-party discovery that the FAA does not. Second, consider impleading the third party as part of the case. If its documents or testimony are so vital to the case, it may be appropriate to bring that third party in as a defendant. Finally, embrace trial by fire. Under 9 U.S.C. § 7, arbitrators can bring third-parties before them, although only for the purposes of a hearing. In some instances, evidentiary hearings dedicated solely to the third-party can be arranged before the main hearing is held. Therefore, careful strategizing early in the

litigation process can help prevent a nasty surprise later on.

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NEGOTIATE YOUR WAIVER AND RELEASE UPON PAYMENT FORMS WITH THE REST OF THE CONTRACT TERMS

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Construction contracts often have a provision that requires the contractor or subcontractor to submit a signed waiver and release with any payment application, as a condition precedent to receiving payment. The contract often states that the waiver and release must be in a form approved by the paying upstream owner or contractor ("Waiver and Release Form"). The contract terms may provide that one Waiver and Release Form is necessary for progress payments, while another form is required for final payment. These forms may be referred to as "lien releases", but in practice they also apply to public projects and typically encompass the right to any type of payment claim.

Theoretically, the Waiver and Release Form is intended to support a fair status quo – in exchange for receipt of a payment, the contractor agrees to release its rights to assert a payment claim for the work covered by the Waiver and Release Form. Accordingly, potential harmful consequences of a Waiver and Release Form are not often on a contractor's radar. Unfortunately, the Waiver and Release Form may extend the waiver and release beyond the scope of the specific payment at issue.

For example, a Waiver and Release Form will often state that the party releases all rights to receive payment for work, materials, equipment, or services provided through a certain date (excluding retainage, in the case of a progress payment). If the contractor was not fully paid under a prior billing, it might waive the right to pursue a claim based on those invoices by submitting such a Waiver and Release Form with subsequent payment applications. To avoid this peril, a Waiver and Release Form should state that the waiver and release does not apply to funds that are due and for which the contractor has not received payment.

In *P & C Const. Co. v. Am. Diversified/Wells Park II*, 101 Or App 51, 57 (1990), the court held that an ambiguous release only applied to labor and materials billed and *paid for* as of the date stated in the release. While the result is encouraging, the decision was not solely based on the language of the release. Rather, the court reviewed the parties' actual conduct with respect to billings and payments in order to reach that conclusion. Similarly, in *Portland Elec. & Plumbing Co. v. Simpson*, 59 Or App 486, 490 (1982), the court held that a broad lien release that accompanied each payment only applied to amounts that were actually paid, and did not limit a material supplier's lien claim for unpaid amounts. The court's decision in *Simpson*, however, was based in part on ORS 87.025(5), which provides that a person making payment is entitled to a waiver of a lien only as to materials or supplies already paid for. Notably, ORS 87.025(5) does not apply to all payment claims. To avoid relying on an interpretation of the parties' conduct or an independent statute, it would be better to simply include an express provision exempting unpaid amounts from the release.

Laurie

Another option is to require the contractor to identify, in the Waiver and Release Form, the specific invoices from prior billings that are not included in the waiver and release. The issue with

this latter approach is that it arguably requires the contractor to identify the same disputed invoices with each and every Waiver and Release Form, until the dispute is resolved. See for example, Judge Mosman's Opinion in a Miller Act case, in which the court held that the contractor waived a known claim to late payment interest by failing to exempt the issue from a release in pay application 18, even though the contractor attempted to exempt the issue from the release in pay applications 19 and 20. *United States for use & benefit of Elting, Inc. v. Hayward Baker, Inc.*, CV 04-1137, 2006 WL 8459281, at *2 (D Or Mar 13, 2006)

Another approach is to have the Waiver and Release Form apply only to specific invoices or the specific payment application period, as opposed to applying to all prior invoices submitted under prior payment applications since the beginning of the project.

While the parties focus on negotiating the more prominent contract provisions, they may not bargain for the terms of the Waiver and Release Form before signing the contract. A contractor that has an attorney review a proposed contract before entering into it, may not retain the attorney to subsequently review a proposed Waiver and Release Form when it comes time to submit the first progress payment application. If a dispute over the terms of a Waiver and Release Form arises at the time of the payment application, it may delay processing of the payment application, which can have a cascading effect on the performance of the work. Thus, assuming the contract requires submission of a Waiver and Release Form with payment applications, it would be prudent to negotiate the contents of such Waiver and Release Form at the same time as the rest of the terms of the contract.

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THE CCB "HANDYMAN EXEMPTION" – WHAT CAN A "HANDYMAN" (OF HANDYWOMAN) DO IN OREGON WITHOUT A CCB LICENSE?

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If you read Nextdoor or similar online sites, you have likely noticed homeowners seeking referrals for a handyman to assist with projects around their house. Homeowners often seek a handyman for smaller projects because they think a handyman will be less expensive than a licensed contractor. While that may be true in many situations, particularly for projects that do not involve plumbing, electrical, or structural work, property owners should be aware of what work a handyman can legally perform in Oregon without a CCB license. They should also be aware of the risks they take when not using a licensed contractor for projects around their house.


Van

Who needs a CCB license?

The primary definition of "Contractor" in Oregon is "a person that, for compensation or with the intent to sell, arranges or undertakes or offers to undertake or submits a bid to construct, alter, repair, add to, subtract from, improve, inspect, move, wreck or demolish, for another, a building, highway, road, railroad, excavation or other structure, project, development or improvement attached to real estate, or to do any part thereof." ORS 701.005(5).

The CCB definition of Contractor, which is similar to the definition of Contractor in Washington, is quite broad. The above definition of Contractor could be interpreted to include work performed by a handyman. There is even a section on the CCB website, titled "Who Needs a

Construction Contractor's License?", which includes Handyman in a list of examples of persons who perform construction work for compensation that are required to have a CCB license.

Exemptions from CCB licensure

While the definition of Contractor in Oregon is fairly broad and could include work performed by a handyman, the CCB licensing statute includes a number of exemptions to licensure. One of those exemptions is the basis of the "Handyman exemption" in Oregon. ORS 701.010(4) states that the following work is exempt from licensure as a Contractor under Oregon's construction contractor licensing laws:

> A person working on one structure or project, under one or more contracts, when the aggregate price of all of that person's contracts for labor, materials and all other items is less than $1,000 and such work is of a casual, minor or inconsequential nature. This subsection does not apply to a person who advertises or puts out any sign or card or other device that might indicate to the public that the person is a contractor.

The $1,000 threshold was increased from $500 in 2013.

The CCB's administrative rules provide some further insight with regard to the Handyman exemption and what type of work can be performed without a CCB license. The definitions in the CCB Administrative Rules (see OAR 812) include what constitutes work of a Casual, Minor, or Inconsequential nature.
OAR 812-002-0120 states as follows:

(1) Casual, Minor, or Inconsequential means work:

a) That does not require a permit;
b) That does not affect the health or safety of the owner or occupant of the structure;
c) For which the aggregate contract price for all work on one structure or project is less than $1,000; and
d) That does not include work done as a subcontractor to a licensee.

(2) Work involving lead-based paint abatement, inspection, renovation or risk assessment of child-occupied facilities or target housing, as those terms are defined in OAR 812-007-0020, affects the health and safety of owners and occupants and is not "casual, minor or inconsequential" work.

Oregon's construction contractor licensing laws are not very handyman friendly. The $1,000 aggregate contract price could eliminate many potential projects, particularly because the $1,000 maximum includes the cost of labor and materials for all work on one structure or project.

The prohibition against work that affects the health or safety of the owner or occupant of the structure would also seem to eliminate many projects. While said language is a bit ambiguous and could be interpreted subjectively, it seems to likely prohibit a handyman from performing plumbing, electrical, or structural work. It would also likely disqualify a handyman from performing demolition work that involves lead or asbestos.

Furthermore, the handyman exemption does not allow the handyman to advertise their services to the public like a contractor. As such, a handyman that is not licensed with the CCB cannot legally advertise their services or put out any sign, card, or other devise that might indicate to the public that they are a contractor.

Subsection 2 of the definition of "Casual, Minor, or Inconsequential work " states that the health or safety of the occupant is affected if the work involves lead-based paint abatement or renovation in residences constructed before 1978 or in child occupied facilities. Said provision likely prohibits a handyman from performing any painting activities in pre-1978 houses or child occupied facilities.

There is very little case law in Oregon to provide guidance with regard to what work a handyman can legally perform in Oregon and what constitutes work of a casual, minor, or inconsequential nature. There is nothing on point. However, the cases do raise another issue relating to the use of an unlicensed handyman- is the handyman an independent contractor or an employee? While that issue is not addressed in this article, it is another factor for a property owner to consider when thinking about hiring an unlicensed handyman to perform work on their real property.

Despite Oregon's laws and rules relating to what work a handyman can legally perform in Oregon, there are plenty of services that a handyman should be able perform without a CCB license. Examples could include fence repairs, door repairs, small painting jobs, power washing, wall mounting TVs, hanging pictures, patching drywall, cleaning gutters, installing baseboards, and many other miscellaneous repairs or maintenance required in a house. In order to stay within the law, the handyman should avoid work that could affect the health or safety of the owner or occupant of the structure.

While a handyman may legally perform many home repair related services in Oregon without a CCB license, homeowners need to recognize that by using a handyman they will not have the protection of the insurance and surety bond required of contractors licensed with the CCB. Owners hiring an unlicensed handyman also do not have access to the CCB complaint and dispute resolution process if there are issues with the work performed by a handyman. Before hiring an unlicensed handyman, a property owner should weigh the risks of doing so versus the benefits of a potentially lower price charged by the handyman. That may be a risk worth taking, especially if the owner got a really good price through a trust-worthy referral source.

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THE POTENTIALLY UNEXPECTED IMPACT OF FLOW-DOWN PROVISIONS

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"Incorporation by reference" is ubiquitous in nearly all construction agreements. Construction contracts universally require the work to be performed "per plans and specifications," without actually appending all the plans and specifications to the contract. Incorporating the plans and specs relating to the work to be performed streamlines the contracting process.

However, prime contractors typically contain a conduit or flow-down clause, requiring the subcontractor to comply with all terms of the prime contract along the lines of the following: "Subcontractor assumes toward Contractor all the obligations and responsibilities which Contractor


Jacob

has assumed toward Owner under the Prime Contract." This and similar blanket or catch-all flow-down clauses seem harmless but can have significant consequences. They not only incorporate outside documents into the subcontract, but they potentially bind the subcontractor to duties unrelated to the subcontractor's work and buried in another document the subcontractor may not have been given an opportunity to review.

For example, a subcontract may not contain a time limit by which written notice of a claim must be provided to the general contractor, but the prime contract may require written notice of claims to be provided to the owner within a certain period of time. A blanket flow-down clause could preclude the subcontractor from submitting a claim outside the time required in the prime contract, which the subcontractor may not be aware of.

Similarly, a subcontract may not specify any particular method of dispute resolution, but the prime contract may state all disputes to be arbitrated in another jurisdiction. A blanket flow-down clause may bar the subcontractor's lawsuit, forcing the subcontractor to arbitrate in a foreign jurisdiction.

A blanket flow-down provision may also have unintended consequences. For example, if the general contractor is required to obtain builder's risk insurance, a blanket flow-down clause means the subcontractor must obtain duplicative insurance. Similarly, if the general contractor is required to include extensive documentation to support pay applications, a blanket flow-down provision means the subcontractor must also submit the same documentation, even where the documentation is far outside normal expectations.

Given the substantial impact of these flow-down clauses, there is little Oregon case law discussing the contours of the incorporation-by-reference doctrine in a construction context. In *Wallace v. Oregon Eng'g & Constr. Co.*, 90 Or 31, 34 (1918), the Court noted that a reference to the general contract for a specified purpose makes it a part of the subcontract but only for the specified purpose. The rule was reflected in *A-C Const., Inc. v. Bakke Corp*., 153 Or App 41, 46 (1998), where the Court noted that the term "[a]ll work to be done according plans and specifications" was insufficient to incorporate the entire prime contract into the subcontract.

However, in *McGrath v. Electrical Const. Co.*, 230 Or 295, 300 (1961), the Court held mere reference to the prime contract was sufficient to incorporate the entire prime into subcontract. Interestingly, *McGrath* cited *Cerino v. Oregon Physicians' Service,* 202 Or 474 (1954) and *Spande v. Western Life Indemnity Co*., 61 Or 220 (1912) to support its conclusion; however, the issue before the Court in *Cerino* was whether the plaintiff had proven the existence of a complete contract. Further, *Cerino* cited *Spande* for the rule of *evidence* that "where an instrument refers in terms to another instrument as containing part of the stipulation between the parties, that other instrument is itself a part of the contract between the parties, and must be produced, in order to fully substantiate the allegation regarding the agreements of the contracting parties." *Cerino,* 202 Or at 483 (quoting *Spande, supra*). Neither *Cerino* nor *Spande* was an incorporation-by-reference case.

Further, the general-versus-specific reference loses sight of the goal of contract interpretation, ascertaining the intent of the parties. Is it logical that the parties intended a subcontractor, no matter how large or small, to assume every obligation the general contractor has to the owner? Does either the general contractor or the owner truly expect every subcontractor, regardless of scope, to share equal responsibility to perform every aspect of the prime contract? Nevertheless, under *Wallace, McGrath*, and *A-C Const., Inc.,* passing references to outside documents may be sufficient to bind the parties to all the terms of outside documents *unless* the reference is limited to a particular or specific purpose. *Waterway Terminals Co. v. P. S. Lord Mech. Contractors,* 242 Or 1, 16 (1965) ("The rule seems to be well established that where reference is made in one document to another

unattached document for a specific purpose only, such other document becomes a part of the former for such special purpose only.") (quoting *Myers v. Strowbridge Estate Co.,* 82 Or 29 (1916)).

Thus, in order to avoid future disputes, it is critical that subcontracts contain a clear description of what obligations are incorporated into the subcontract.

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DISCOVERY AND ADMISSIBILITY LIMITATIONS ON "LESSONS LEARNED" AND PEER REVIEW MATERIALS

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The states of Missouri and Kansas have both passed legislation providing design firms with discovery and admissibility protections on peer reviews and "lessons learned" presentations regarding professional services. *See* MO Rev Stat § 537.033 (2013); *see also* KS Stat § 74-7047 (2014). Before the COVID-19 pandemic, Oklahoma was poised to consider a similar bill.


Justin

These statutes make "The reports, statements, memoranda, proceedings, findings and other records submitted to or generated by any peer review committee or peer reviewer" privileged and not be subject to "discovery, subpoena or other means of legal compulsion for their release to any person or entity or be admissible in evidence in any judicial or administrative proceeding." The design professional who retains, employs, designates or appoints the peer reviewer is the holder of the privilege. The Oklahoma bill further provides that peer reviewers would be immune from civil liability for such services "so long as the acts are performed in good faith."

This is modeled on developments in the law applicable to medical professionals. Congress enacted the Health Care Quality Improvement Act of 1986 (HCQIA) in order to promote professional peer review to reduce medical malpractice. Like physicians, architects and engineers are licensed to regulate life safety impacts of their work.

Proponents of this legislation argue that it is in the interest of the health, safety, and welfare of our communities that design professionals be permitted to seek peer review of their work on the front end at the design stage, and also to learn from their own mistakes and the mistakes of others as projects perform. Opponents of this legislation argue that evaluations of the fitness of a design decision and the impact on life safety should be available to injured parties, later, in order to evaluate both the professional standard of care, and whether a professional or firm met that.

Another consideration that is not raised as often in evaluating this type of legislation is to what extent these limitations on discovery and admissibility of peer review and lessons learned information should be extended to other disciplines and professions. Certainly, construction contractors are also regulated to ensure the health, safety, and welfare of the public, as well as the health and safety of construction workers. While under ORS 40.185 (OEC Rule 407), there are limitations on the use of evidence of subsequent remedial measures, these subsequent remedial measures do not just appear in a vacuum. Rather, they are the product of communications and evaluations which address the bases of these regulated professions.

As additional jurisdictions consider developing these types of protections, there are both opportunities and limitations that need to be evaluated about how this rationale translates into other regulated activities.

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