

Issues & Answers

COMMERCIAL LITIGATION

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New Rules Require All Parties to Lawsuits to Consider Alternative Dispute Resolution (ADR) Techniques

By Keith Hendricks and Paul Moore

Almost 95% of all lawsuits are settled before a verdict is rendered. Despite this fact, there is a strong perception that lawsuits are too expensive, last too long, and that court dockets are too crowded. To address this concern, both the courts and the legislature have adopted various “alternative dispute resolution” or “ADR” mandates to strongly encourage, if not strong-arm, voluntary settlements. Two recent changes worth noting include a change to the statutory attorney fee provision for contract cases, A.R.S. § 12-341.01, and a new court adopted rule, Rule 16(g) of the Arizona Rules of Civil Procedure, which requires all parties to consider ADR.

ATTORNEYS’ FEES CAN BE AWARDED AGAINST ANY PARTY WHO REJECTS A REASONABLE SETTLEMENT OFFER

Arizona has long allowed the successful party in a lawsuit over a contract to recover attorneys’ fees. See A.R.S. § 12-341.01. The initial goal of this statute was to discourage questionable claims or defenses in contract cases and to make the successful party whole by awarding fees.

To add even more teeth, the legislature has recently amended A.R.S. § 12-341.01 to more strongly encourage settlement. In a contract case, the legislature has now provided that where a written settlement offer is rejected, the party rejecting the offer must obtain a judgment that is better than the offer made, or else the party making the settlement offer will be deemed to be the successful party from the time the offer was made and entitled to attorneys’ fees. Either the plaintiff or the defendant can make the settlement offer, and either the plaintiff or defendant can be deemed the “successful

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party” and recover attorneys’ fees even if they lost on the majority of the claims, as long as they did better than what they offered by way of settlement.

This change creates substantial leverage for settlement negotiations, as the cost for ignoring a reasonable settlement proposal may end up being an obligation to pay the attorneys’ fees for both sides of the litigation from the time when the written settlement offer was made. This change also encourages settlement offers to be made earlier in the case so that more of the attorneys’ fees can be recovered.

COURTS NOW REQUIRE THE PARTIES TO CONSIDER ADR

In addition to the changes adopted by the legislature, the courts are now requiring the parties to any civil litigation matter to meet and discuss the possibility of ADR. Last December, the courts adopted Rule 16(g) of the Arizona Rules of Civil Procedure. This Rule requires the parties to file a report in the first 90 days of the case detailing discussions between the attorneys about using various ADR techniques.

The various types of ADR that the courts want the parties to discuss include the use of a private mediator, the use of a court-appointed mediator, binding arbitration, or a summary jury trial (where a small jury is chosen and the basic facts are presented by the lawyers). There are a number of other recognized ADR

techniques that could be discussed. If the parties agree to utilize one of the approved ADR techniques, the courts no longer require non-binding arbitration for cases where less than \$50,000 is in dispute.

If the parties fail to file the ADR report with the court, one party fails to meet and discuss ADR, or the court feels that any party is not acting in good faith, the court can order the parties to discuss ADR with a court-appointed ADR specialist. Additionally, under the existing Rule 16.1 of the Arizona Rules of Civil Procedure, any party and the court has the right to demand that the parties participate in a mandatory settlement conference or mediation. In Maricopa County, these mandatory court settlement conferences are administered by the ADR office of the Maricopa County Superior Court, and are assigned to various lawyers who have volunteered to act as mediators.

There are many advantages and disadvantages with almost all forms of ADR. The primary advantage of ADR is that the parties control costs, and ensure against unknown or unexpected results from a jury verdict. A common disadvantage is that most forms of ADR require a compromise of some kind. Often times, a resolution reached through ADR will not leave any party completely happy with the outcome.

There are also some specific disadvantages to various types of ADR. For example, court-appointed mediators do not charge for their services, but they may not be highly

motivated or skilled in bringing the parties to a settlement, and the parties may only attend because the court requires it. Private mediators are often more motivated and persuasive, and parties who voluntarily agree to appear before a private mediator and pay for their services are usually more motivated to settle. On the other hand, there can be substantial costs with private mediation. Skilled mediators typically charge between \$200 and \$300 per hour. While often less expensive and quicker than a jury trial, binding arbitration is more expensive than mediation, is usually not appealable, and rests on the decision of one or a small number of arbitrators. There is also a perception that arbitrators often simply “split-the-baby.” Summary jury trials and other types of techniques are also typically not appealable, and can involve substantial costs. All of these pros and cons must be weighed against the costs, in terms of both money and emotion, of standard litigation.

Although a court can never compel a party to settle a case, the parties’ willingness to participate in ADR and the reasonableness of their positions during settlement or ADR discussions are now taking a primary role in determining whether attorneys’ fees should be awarded, especially in contract cases. As such, the sheer economics of civil litigation and current rules and statutes require that all parties now, more than ever, consider ADR in connection with any business or personal dispute. For more information, please contact Keith Hendricks or Paul Moore at 602-916-5000. ■

Arizona Supreme Court Considering Proposed Amendment to Rule Governing Protective Orders

By Andrew Federhar, James Bush and Nikki Austin

Although the timely and efficient resolution of disputes is facilitated by rules requiring

parties to a lawsuit to engage in disclosure of relevant information, such pretrial discovery processes can often encroach on a party’s legitimate privacy concerns. For instance, discovery often requires litigants to disclose highly private and sensitive materials such as trade secrets, company finances, research data and marketing strategies. In order to shield litigants from the potentially harmful consequences of pretrial disclosure, Rule 26(c) of the Arizona Rules of Civil Procedure presently grants the court, “for good cause shown,” substantial discretion to

enter protective orders. The purpose behind a Rule 26(c) protective order is to guard against “annoyance, embarrassment, oppression, or undue burden or expense” by restricting the use and dissemination of information generated by virtue of the liberal discovery process.

Upon entry of a protective order by the court, parties to a lawsuit who disclose sensitive materials receive judicial safeguards from public access and scrutiny

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of such information. Recipients of materials protected pursuant to a protective order are controlled in their dissemination and use of the materials disclosed during litigation, and are subject to court imposed penalties which may include monetary fines for violation of the terms of a protective order. A protective order is therefore an important tool in the protection of a litigant's private information.

On January 30, 2002, however, a proposed amendment to Rule 26(c) was filed with the Arizona Supreme Court designed to significantly dilute the court's authority to enter protective orders in state court actions for injury or wrongful death alleged to be caused by defective products or environmental hazards. The proposal was not based on any study or expression of concern by any government agency or official charged with the protection of public health or safety, and did not cite evidence of any abuse of protective orders from any source. Rather, the petition stemmed from a "request" from a plaintiffs' attorney's bar group. Its premise was that protective orders foster "secrecy" in the courts. Legislative changes have been sought throughout the country with respect to protective orders at both the state and federal levels.

In response to the proposed amendment, the Arizona Supreme Court recently circulated for comment a staff-generated proposed amendment to Rule 26(c), which provides as follows:

Before entering an order in any way restricting a party or person from disclosing information or materials produced in discovery to a person who is not a party to the litigation in which the information or materials are being discovered, a court should consider and make findings of fact concerning any relevant factors, including but not limited to:

(i) Any party's need to maintain the confidentiality of such information or materials; (ii) Any nonparty's need to obtain access to such information or materials; and (iii) Any possible risk

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to the public health or safety to which such information or materials may relate or reveal. Any order restricting release of such information or materials to nonparties should use the least restrictive means to maintain any needed confidentiality.

The proposed staff amendment would change Rule 26(c) in two significant ways. First, the proposal would give "nonparties" the right to be heard and potentially to have a public right of access to information that is totally separate from the interests of the parties to the litigation. Second, the proposal eliminates the ability of the parties to stipulate to the terms of a protective order without active court intervention.

Under the proposed amendment, the court, "before entering any order" restricting information to a person "who is not a party," would be required to "make findings of fact" concerning relevant factors including "any possible risk to the public health or safety to which such information or materials may relate or reveal." By mandating "findings of fact...before entering any order" with

respect to any possible risk to the public health or safety, the proposed new rule creates the need for an evidentiary hearing on issues that may not only be more complex, but totally different from those controlling the main action. Since judges are not required to possess the scientific expertise to make judgments concerning "any possible risk to the public health or safety" in any contested motion for a protective order, a prolonged hearing can be expected with experts on both sides of the issue.

In the case where there is neither a contest nor a "nonparty" before the court, the proposed rule does not relieve the court from "making findings of fact" before entering an order. There are no presumptions about the parties' stipulation with respect to possible risks to public health or safety nor is there any standard by which a court is to exercise its discretion in deciding about the protective order or its scope and duration.

Currently, Fennemore Craig is taking an active role in opposing any changes to Rule 26(c). While proponents of proposed changes to Rule 26(c) argue

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that the existing rule shields information from the public that is necessary to protect against health and safety hazards, the present form of Rule 26(c) appropriately balances a party's right to discovery of relevant information with countervailing privacy interests guaranteed under Article 2, Section 8 of the Arizona Constitution.

Allowing the court to issue protective orders on anything other than a showing of good cause would put Arizona at odds with almost every other state in the nation in the way confidential information is

treated. Moreover, proprietary information, such as that commonly subject to disclosure in pretrial proceedings, typically costs a significant amount of money to develop and maintain. Allowing unfettered public access to such information raises important questions with respect to an unconstitutional taking of property.

Proposed changes to Rule 26(c) were previously considered by the Advisory Committee on Civil Rules of the United States Judicial Conference, which determined that similarly proposed

changes to the federal rules would impose significant burdens on the judicial system and that protective orders did not impede public access to information on health and safety hazards. The Committee ultimately concluded that no changes were warranted.

On behalf of several clients, Fennemore Craig recently filed a Comment to Proposed Amendment to Rule 26(c) in the Arizona Supreme Court urging the Court to reject the proposed amendment. For more information, please contact Andrew Federhar or James Bush at 602-916-5000. ■

Complex Civil Litigation Division for Superior Court Proposed by Supreme Court Task Force

By Andrew Federhar

The Complex Litigation Study Committee was formed to promote public trust and confidence in the Arizona judicial systems in December 2001.

Then Chief Justice Tom Zlaket established a committee to address whether a complex litigation court/business court or other model will:

- expedite the resolution of disputes through improved court efficiency;
- reduce costs through the use of technology;
- provide effective case management; and,
- encourage consistent decision-making.

Andrew Federhar, a director at Fennemore Craig, chairs the Committee. Other members include representatives of law firms who regularly handle complex civil matters, corporate general counsel, superior court judges, court administrators, a policy analyst for an independent public

policy center, a state senator, a clerk of court, a representative of the Center for Law in the Public Interest, a representative of the American Trial Lawyers' Association and a retired supreme court justice.

The Committee met regularly over a six-month time period and heard testimony from the Chief Justices of California and New York's highest courts. In addition, the Committee studied the business and complex case courts of more than a dozen states, including a report from the Executive Director of the National Center for State Courts. Based on this study, the Committee recommended an initial model program for Maricopa and Pima Counties with review about its application statewide.

The recommended program will create a complex litigation court with its own roster of judges. It will offer civil litigants an opportunity to have one judge preside over their case from initial filing to completion by removing select judges from the normal two-year rotation schedule. Program judges will be trained in complex case management; they will also be provided with staff attorneys to assist in legal research and writing; and they will be provided with access to new technologies designed to accelerate pre-trial and trial processes and reduce expenses. Increased oversight by the trial judge will be the primary feature of the program. Parties can expect regular conferences with the judge designed to

minimize discovery disputes and streamline the process of resolving issues by motion, mediation or trial, as appropriate.

The Committee's initial report proposes three new procedural rules applicable to cases assigned to the program. These rules are intended to supplement the existing rules of civil procedure. The new rules specify the process for designating eligible cases (Rule 8(i)), the issues to be addressed in the mandatory initial case management conference (Rule 16.3), and the options the judge may choose from in managing the trial process (Rule 39.1).

These changes take advantage of new technologies. Electronic filings, on-line discovery sites and remote access to files are all features proposed by this new system. The proposal also takes advantage of new technologies in the courtroom to assist in the presentation of complex issues to jurors and the court. When implemented, this will bring Arizona's courts to the forefront nationally in the implementation both of new technology and dispute resolution.

The Committee's Initial Report is available online at www.supreme.state.az.us/complexlit. To discuss how this might impact you, or answer any questions that you might have, please call Andrew Federhar at 602-916-5301 or email him at federhar@fclaw.com. ■

Arizona Supreme Court Expands the Implied Duty of Good Faith in All Contracts

By Keith Hendricks

Arizona courts have long held that every contract contained an implied duty to act in good faith and with fair dealing. In a case arising out of litigation over former Governor Fife Symington's Mercado project, the Arizona Supreme Court recently expanded this implied duty. Under the Supreme Court's expansion of the implied duty of good faith, a party can now allege a breach of contract where the other side takes an action inconsistent with risks allegedly assumed in a contract, or for reasons inconsistent with the other party's justified expectations. Such allegations are controlled by the facts of the transaction, and not necessarily the language of any documents. In addition, a party's reasonable expectations under a contract are important in determining whether there is a breach.

The Supreme Court's decision on the implied covenant of good faith and fair dealing was announced in the case Wells Fargo Bank v. Arizona Laborers, Teamsters and Cement Masons Local No. 395 Pension Trust, 201 Ariz. 474, 38 P.3d 12 (2002). This case arises out of Symington's efforts to obtain financing for his Mercado project.

In the late 1980's, Symington was developing the Mercado project. He approached First Interstate Bank, which was later acquired by Wells Fargo Bank, to seek financing for the Mercado project. The bank declined to provide permanent financing, but agreed to provide the construction financing as long as Symington obtained a permanent lender. He obtained a permanent loan commitment from various pension funds. Under the permanent loan commitment, the pension funds could decline to close on the loan if Symington failed to pay his debts as they became due, or defaulted on any other loan obligations. At the bank's

request, Symington, the pension funds, and the bank entered into a tri-party agreement regarding their various obligations to each other. Under the tri-party agreement, the bank was authorized to volunteer information regarding Symington's financial well-being to the pension funds, but the bank was not obligated to provide this financial information.

As the construction on the Mercado project was completed, Symington's real estate ventures and his general financial condition deteriorated. Neither Symington nor the bank disclosed the deterioration of Symington's financial condition to the pension funds. It was alleged in the Wells Fargo lawsuit that the bank knew that Symington was providing false information to the pension funds and that the bank actually helped Symington defraud the pension funds because the bank wanted the pension funds' loan to close.

In proceedings before the trial court, the bank argued that under its contract and common law it was not obligated to provide the pension funds with any information regarding Symington's financial status. The trial court agreed and dismissed the pension funds' claims. The Arizona Court of Appeals also agreed with this position and affirmed the trial court's action. The case was then brought to the Arizona Supreme Court. The Arizona Supreme Court disagreed, holding that the allegations in the complaint stated a claim for: (1) aiding and abetting a fraudulent act; (2) breaching the implied covenant of good faith and fair dealing; (3) interfering with contractual relations; and (4) fraudulently concealing material information. The Arizona Supreme Court ruled that the pension funds were entitled to present these claims to a jury. Notably, in ruling on the implied covenant of good faith and fair dealing, the Arizona Supreme Court expanded the doctrine.

Prior to the Wells Fargo case, the implied covenant of good faith and fair dealing was described by the courts as a doctrine that prohibits "a party from doing anything to prevent other parties to the contract from

receiving the benefits and entitlements of the agreement." See Rawlings v. Apodaca, 151 Ariz. 149, 153-54, 726 P.2d 565, 569-70 (1986). Because the tri-party agreement specifically provided that the bank was not obligated to provide information to the pension funds, the bank argued that it could not breach an implied duty of good faith when it failed to provide this information. The Arizona Supreme Court held that even if the bank did not breach the literal language of the contract, a jury could find that the bank breached the implied duty of good faith if it acted for a reason outside the risks assumed by the pension funds, or for reasons inconsistent with the pension funds' justified expectations.

The Wells Fargo case stated a new test to determine if there is a breach of the implied duty of good faith. The Court held that where one party "wrongfully exercises the contractual power for a reason beyond the risks that the [other party] assumed, or for a reason inconsistent with the [other party's] justified expectations," there could be a breach of the implied duty of good faith.

The Wells Fargo case makes it clear that the party's reasonable expectations under a contract are important in determining whether there is a breach. If a party to a contract acts unfairly, or in a manner inconsistent with the other side's reasonable expectations, then there may be a claim of a breach of the implied covenant of good faith even if there is no violation of a specific provision of the agreement.

Because the question of whether there has been a violation of the implied duty of good faith is primarily a factual question, it will probably now be more difficult to obtain a ruling from a judge as to whether there has been a breach of contract before the case is set for a jury trial. As such, it is now more important than ever for a party to be able to demonstrate that it has objectively acted in good faith with regard to the other party in the contract. For more information, please contact Keith Hendricks at 602-916-5000. ■

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