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APCO Constr. v. Zitting Bros. Constr., 136 Nev. Adv. Op. 26 (Oct. 8, 2020)

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CIVIL LITIGATION: BREACH OF CONTRACT – ENFORCEABILITY OF “PAY-IF-PAID”
CONTRACTUAL PROVISIONS

Summary

In *Lehrer McGovern Bovis*, Nevada’s Supreme Court held that pay-if-paid provisions in construction contracts, whereby a subcontractor is paid only if the general contractor is paid by the property owner for the work, are generally unenforceable because they violate public policy.² However, this decision caused some confusion surrounding the enforceability of pay-if-paid provisions, leaving some believing they were no longer enforceable post-*Lehrer*. Here, the Court took the opportunity to clarify its stance on the enforceability of pay-if-paid provisions in Nevada.

Background

This case involves a dispute between a contractor (APCO Construction, the appellant) and a subcontractor (Zitting Bros. Construction, the respondent) involved in a development project in Las Vegas, which was terminated in the midst of the 2008 recession. In 2007, APCO, the general contractor for the development project, entered into a subcontract agreement with Zitting to perform woodframing, sheathing, and shimming work on the project. The subcontract included a “pay-if-paid” provision, which means that payment to Zitting was conditioned upon APCO’s receipt of payment from the property owner (Gemstone Development West, Inc.). The subcontract also conditioned payment to Zitting on common conditions precedent, such as completion and approval of work. The subcontract also provided that if the contract between Gemstone and APCO were terminated, APCO were to pay Zitting for completed work after Gemstone paid APCO. Finally, the subcontract provided that in the event of litigation, the prevailing party would be entitled to costs and attorney fees.

In August 2008, APCO and Gemstone terminated their contract. Subsequently, Camco Pacific Construction Company became general contractor. Zitting continued to work under Camco until Gemstone shut down the project in December 2008, after its lenders ended its financing. Consequently, APCO, Zitting, and other subcontractors were not paid and filed multiple lawsuits and mechanics’ liens.

In 2009, Zitting sued APCO and Gemstone for breach of contract, foreclosure of a mechanics’ lien, and various other claims, seeking around \$750,000 for work completed while working under APCO.³ The district court granted summary judgment in favor of Zitting’s breach

¹ By Brendon N. Brandão.

² *Lehrer McGovern Bovis, Inc. v. Bullock Insulation*, 124 Nev. 1102, 1117-18, 197 P.3d 1032, 1042 (2008).

³ The underlying litigation was stayed for six years to resolve the lien priority between APCO’s mechanics’ liens and the construction loan deed of trust held by the project’s lender. Ultimately, the lender received the net proceeds of the project’s sale, leaving contractors and subcontractors unpaid.

of contract and mechanics' lien claims, concluding that the pay-if-paid provision were void and unenforceable.

Discussion

The district court did not err in granting summary judgment in favor of Zitting on its breach of contract claim

APCO claimed that if pay-for-pay provisions were enforceable, then the district court abused its discretion in precluding APCO's defenses and that genuine issues of material fact precluded summary judgment. The court disagreed as it held that the pay-if-paid provisions were void and unenforceable.

The pay-if-paid provisions are void and unenforceable

APCO argued that the pay-if-paid provisions in the parties' subcontract were enforceable. The Court, however, rejected this argument by pointing to its own precedent, Nevada law, and public policy. NRS 624.628(3) provides protections for subcontractors by deeming contractual provisions void and unenforceable if they require subcontractors to waive rights listed in NRS 624.624 to NRS 624.630.⁴ One of the rights that NRS 624.628(3)(a) protects, is a subcontractor's right to prompt payment for labor, materials, and equipment.⁵

In *Lehrer McGovern Bovis*, Nevada's Supreme Court held that because a pay-if-paid provision limits a subcontractor's ability to be paid for work already performed, such provision interferes with the subcontractor's statutory right to place a mechanics' lien on the construction project.⁶ In addition, the Court held that Nevada's public policy favors securing payment of contractors' labor and used materials, and thus, it concluded that such provisions are unenforceable as a matter of public policy.⁷

The district court, relying on *Lehrer McGovern Bovis*, concluded that the parties' contractual pay-if-paid provision was unenforceable. However, the Supreme Court here noted that, although the result of the district court's ruling was correct, the lower court erroneously held that all pay-if-paid provisions are per se void and unenforceable. Rather, the Court clarified that pay-if-paid provisions require a case-by-case analysis to determine whether they are permissible under NRS 624.628(3), relieve general contractors of their obligations or liabilities under NRS 624.624-.630, or require subcontractors to waive their rights to damages or time extensions.

Here, the Court concluded that the parties' subcontract appeared to contain a schedule of payment that required APCO to pay Zitting within fifteen days after payment from Gemstone, akin to a pay-when-paid provision, which are more often permissible. However, other provisions in the

⁴ NEV. REV. STAT. § 624.628(3) (2009).

⁵ NEV. REV. STAT. § 624.628(3)(a) (2009) (protecting payments as provided by NEV. REV. STAT. § 624.624 (2009)).

⁶ *Lehrer McGovern Bovis, Inc. v. Bullock Insulation*, 124 Nev. 1102, 1117-18, 197 P.3d 1032, 1042 (2008).

⁷ *Id.* at 1041-42.

subcontract conditioned payment to Zitting solely upon APCO receiving payment from Gemstone, which is why the subcontract's provisions were actually pay-*if*-paid provisions. As a result, Zitting would not be paid as required under NRS 624.624(1)(a) if APCO did not receive payment from Gemstone, even if all other conditions precedent in the contract were met (i.e., Zitting's full performance of its work and Gemstone's acceptance).

Accordingly, the Court concluded that the parties' pay-if-paid provisions limited Zitting's right to prompt payment under NRS 624.624(1), thus limiting Zitting's recourse to a mechanics' lien—a right specifically established by Nevada law to protect contractors and subcontractors and to prevent unjust enrichment of property owners.

The district court's preclusion of APCO's evidence in support of its other conditions-precedent defenses was not an abuse of discretion

APCO argued that precluding it from using its conditions-precedent defense was an abuse of discretion. The NRCP requires a party to supplement its responses after a discovery request if it later acquires new information.⁸ Here, APCO did not supplement its interrogatories in a timely fashion. In order to avoid preclusion of APCO's evidence, it would have had to prove that its failure to disclose was substantially justified or harmless.⁹ APCO did not do so therefore, the district court did not abuse its discretion in precluding APCO's evidence in support of its defenses.

The district court properly granted summary judgment in favor of Zitting on its foreclosure of its mechanics' lien claim

APCO argues that the district court erred in granting summary judgment because APCO has no ownership interest in the property. The court here held that under the plain language of NRS 108.239(12), a judgment against the "party legally liable for it" is allowed, not just against the "owner".¹⁰ Here, per the contract, APCO is legally liable for the unsatisfied lien claim so the court affirmed the summary judgment in favor of Zitting.

Conclusion

In deciding this case, the Court clarified that pay-if-paid contractual provisions are not per se void and unenforceable in Nevada. However, such provisions may easily impair important rights that subcontractors have under Nevada law, namely the right to prompt payment. Such provisions could be enforceable in limited circumstances, subject to the restrictions laid out in NRS 624.624-.626 of Nevada's Prompt Payment Act. Accordingly, pay-if-paid provisions require a case-by-case analysis to determine whether they are permissible.

⁸ NEV. R. CIV. P. 26(e)(1).

⁹ See *Pizarro-Ortega v. Cervantes-Lopez*, 133 Nev. 261, 265, 396 P.3d 783, 787 (2017).

¹⁰ NEV. REV. STAT. § 108.239(12) (2017).