CONSTRUCTION BUSINESS OWNER

LAW

How to Prepare Dispute Resolution Clauses with Your Company's Best Interests in Mind

Advice for handling this legal dilemma when the entire project team is involved

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Architects and engineers (A/Es) regularly prepare the contract documents for projects, starting with the contract between the A/E and the owner and following with the contract documents between the owner and the prime contractor.

It is an all-too-common occurrence that, in doing so, the A/E will include a mandatory arbitration provision in its contract with the owner compelling that all claims and controversies between the A/E and the owner be heard in arbitration.

Conversely, in preparing the project contract documents, the same A/E will include a dispute resolution clause that requires that claims and controversies between the contractor and the owner be heard in court.

The consequence of these inconsistent dispute resolution forums, however, is—barring some state law statute or court decision otherwise—to place the owner in the entirely untenable position that, if a claim arises where the A/E and the contractor are both arguably at fault, the owner will have to choose whether to pursue one party to the exclusion of the other party, to pursue both parties at the same time in

different forums, or to pursue one party and then, when that proceeding is complete, pursue the other party.

The ramifications to the owner are palpably unfair. If the owner pursues one party to the exclusion of the other party, the party against whom it is claiming will assert in arbitration or court that the other party is at fault. This is known as “trying the empty chair.”

If the owner simultaneously files an arbitration against the A/E and a court action against the contractor, the owner will find itself in the same “empty chair” dilemma and will also be incurring twice the cost and expense. If the owner pursues one party and then, if the result is not satisfactory, opts to pursue the other party, it will be faced with the argument of advancing inconsistent positions, the “empty chair” defense, and will also incur twice the cost and expense.

In many such situations of inconsistent dispute resolution clauses, the owner will choose to solely pursue the contractor because: (a) it likely has a closer relationship with the A/E; (b) the A/E will be advocating that the claim is due solely to the contractor’s fault; (c) the A/E will assert to the owner that it has a high deductible on its errors and omissions insurance policy and both the A/E and its carrier will vigorously fight the claim; and (d) the owner will not want to be litigating on two fronts with the attendant double cost and expense.

This situation is why the practice of some of A/Es in drafting contracts with inconsistent dispute resolution clauses puts the A/E’s interests over the interests of its client-owner, as the situation acts as a de facto limitation of A/E liability.

Client-owners must be cognizant of this risk at the very outset of the project when the client and A/E are in the “honeymoon” phase of the project and the A/E presents its contract to the owner. Owners should immediately reject an arbitration clause in a proposed A/E contract that provides for arbitration, but does not allow for consolidation or joinder of other claims and parties to the arbitration.

If the owner is agreeable to arbitration with the A/E on those terms, it should include a clause in the A/E contract that requires the A/E to include a term in the contract documents providing that the contractor will be bound to an identical arbitration clause that allows for consolidation or joinder of other claims and parties. Further, when the contract documents are issued, the owner should confirm that the clause has been included in the contract with the contractor. In this way, the owner will retain the right to bring claims against both the A/E and the contractor in the same arbitration forum.

If the A/E is resistant to these requested modifications to the dispute resolution clause of its contract with the owner, then the owner should immediately find a new A/E.

The best and most proactive approach for an owner as to dispute resolution would be for the owner to draft its own dispute resolution clause for incorporation in the A/E contract and the contract with the contractor that provides for consolidation or joinder of claims and parties and that, if a claim arises, the owner shall have the sole right to elect between arbitration or court as the chosen forum.

The identical clause should be included in the contract between the owner and the contractor. In just about every state where courts have considered such clauses in arm’s length, commercial transactions, such clauses have been upheld as enforceable.