

EVEN A CONSTRUCTION CONTRACT WHICH MANDATES “LITIGATION” MAY BE SUBJECT TO “ARBITRATION”

By: Randy J. Heller, Esq.

CONTRACTING PARTIES ARE GENERALLY FREE TO SELECT their own method for dispute resolution. Some standard AIA contracts even let you “check the box,” opting for arbitration, litigation or mediation. However, parties to a construction contract who have mutually agreed to resolve their disputes by litigation in a court of law, might be surprised to learn that they may still be obligated to resolve certain of their disputes before an arbitrator — with no right of appeal. Worse yet, they may find themselves battling it out in both forums in order to get full relief.

A recent Appellate Division, Third Department decision addressed a New York law allowing a party that has not been paid to file a complaint seeking an “expedited arbitration.” Until recently, contracting parties have been writing their contracts to get around this statute. The Court found that in certain circumstances, no matter what the language in the contract, a party can no longer evade the New York law.

New York General Business Law, article 35-E (the Prompt Payment Act or “PPA”) gives certain protections to contractors and subcontractors working on private construction projects where the amount of the contract is over \$150,000 (except for one, two or three-family residential dwellings and some other limited exceptions). The PPA aims to protect parties particularly in the area of the timeliness of payment.

But the real benefit of GBL article 35-E involves the remedies available to a party that has not been paid in accordance with the statute. The aggrieved party may, upon 10 days’ notice, suspend its work. It may then, after making a good faith attempt to resolve the dispute, file a complaint with the American Arbitration Association for “expedited arbitration.” The award of the arbitrator is final and basically unappealable.

Interestingly, section 756-a of the PPA states that “except as otherwise provided in this article, the terms and conditions of a construction contract shall supersede the provision of this article and govern the conduct of the parties thereto.” Thus, for a time after the passage of the PPA, owners and contractors often took pains to expressly over-

ride the short payment durations in the statute and the right to elect expedited arbitration. Some contracts expressly created longer periods for payment; and some contracts went so far as to call for the application of a foreign state’s law in an effort to render the PPA entirely inapplicable. Gradually these loopholes were closed by amendment of the statute.

In a recent case, the Appellate Division, Third Department was confronted with a case in which the construction contract had expressly called for litigation of all disputes. When the unpaid subcontractor pursued expedited arbitration before the AAA, the contractor sought to stay the arbitration, resting on the litigation clause in its contract. The lower court denied the stay, and the appellate court affirmed the denial. The court cited section 757(3) of the PPA, which stated that certain types of contract clauses could not be used to supersede the terms of the statute. In particular, one may no longer evade the provisions of the PPA by (i) providing that the laws of another state apply; or (ii) providing that the other party is forbidden to suspend its work for non-payment; or (iii) changing the payment timetables of the statute; or (iv) making unavailable expedited arbitration for violation of the payment provisions of the PPA.

The result was that the conflict between the litigation clause of the contract and the expedited arbitration remedy in the statute was resolved in favor of arbitration. Thus, the contractor who thought he had eliminated the possibility of being dragged into arbitration, found himself in that

forum—battling over the amount due to the subcontractor (with statutory interest of 1% per month!) and no right of appeal. And since the scope of the arbitrator’s authority may not extend to other disputes between the parties, not addressed by the PPA, it may well be that the parties will find themselves having to appear in two separate forums to get complete relief. This presents yet another consideration in determining which dispute resolution option to select.

Parties to a construction contract who have mutually agreed to resolve their disputes by litigation in a court of law, may still be obligated to resolve certain of their disputes before an arbitrator — with no right of appeal. Worse yet, they may find themselves battling it out in both forums in order to get full relief.



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