

Professional Services

Considerations in deciding to include arbitration provisions in your construction contracts



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When drafting and negotiating contracts with an architect, general contractor, construction manager, or even trade contractors, one important choice a developer or property owner faces is whether to litigate any potential disputes in a court of law, or to include a provision in the contract to compel arbitration instead. There are several important factors to consider in making the choice, chief among which are: 1. Whether the draft construction contracts include “notice” clauses for extra work claims and time extension requests; 2. The cost and time involved in arbitration versus those involved in litigation; and 3. The qualifications of potential judges or arbitrators.

It is to the benefit of a developer or owner to make sure that a properly drafted construction contract contains provisions which make the providing of notice a condition precedent to any contractor’s claims for extra costs incurred due to the contractor’s performance of disputed work, or for an extension of time to complete the

work. These notice provisions require the contractor to notify the developer of the performance of extra work or the need for the time extension within a few days after the occurrence of the extra work performed, or of the event causing the delay. Where such notice provisions exist, the contract should also provide that if a contractor fails to comply with the notice provisions, it will be deemed to have waived its claims. In many cases the contractor has a claim for extra work that would otherwise be valid, but because the contractor does not advise the owner of its claim until the work has already been performed, it will be unable to collect from the owner thereon.

If the draft contract includes such notice provisions, a developer should also choose to omit an arbitration clause. Generally speaking, judges will more likely enforce notice provisions, and bar improperly noticed claims. Arbitrators, on the other hand, may very well overlook notice provisions and render decisions on equitable grounds rather than follow existing law

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with a notice provision, which would allow it to avoid spending tens of thousands of dollars on legal fees that might otherwise accompany discovery and trial of a lawsuit. Arbitrators are more reluctant to dismiss claims on a motion, and, besides, may ultimately decide in favor of the contractor and award the contractor the costs of any extra work even if it failed to abide by the notice provisions of the contract.

The costs of litigation versus arbitration are another important consideration. Historically and currently, arbitration proceedings have resolved disputes sooner than litigation, particularly where pre-discovery dismissal would not be available. While court litigation can easily take two to three years or more before a resolution is achieved, arbitration proceedings gen-

erally conclude within a few months. This is largely because the litigation process allows for much more pre-trial discovery (i.e., interrogatories, document requests, depositions, etc.) than is permitted in arbitration. There is no doubt that the more discovery procedures are used by the parties, the longer it takes to resolve the disputes and the higher the legal fees. Thus, particularly where a developer will not be able to win a motion to dismiss, this factor favors an arbitration clause.

The qualification of the trier of fact should also be taken into account in choosing arbitration or litigation. While a judge may have some experience adjudicating construction disputes, judges are often assigned at random, and thus there is no guarantee that a judge will know anything about construction. In arbitration, on the other hand, the parties mutually agree upon an arbitrator. To assist in the

selection, the organization with which the arbitration demand is filed will provide a list of potential arbitrators who either worked in the construction industry themselves, or who are attorneys who specialize in construction law. Thus, the parties may ensure that the arbitrator has a good command of the subject matter of the dispute. Many construction industry clients become frustrated with court proceedings where the judge has little familiarity with construction or the construction process, and selecting arbitration instead eliminates this concern.

In deciding whether to include an arbitration provision in a contract, the developer should weigh all of the factors discussed above. Most importantly, however, when the need arises to draft a construction contract, the developer should consult with an attorney who concentrates in construction law and litigation to assess the relative strengths and weaknesses of arbitration and litigation with regard to the particular project for which the contract is being drafted.

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