Beware of Waiving ADR in Your Settlement Agreement

Judge Abraham J. Gafni (Ret.)
Published on July 26, 2019 in The Legal Intelligencer

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After a protracted negotiation or mediation resulting in a settlement, parties are often eager to memorialize the result on the spot. Accordingly, they will prepare an abbreviated memorandum that summarizes the essential elements of the agreement with the expectation that the settlement details will be fleshed out later in a more formal document.

Moreover, at this stage, they generally focus on the substantive elements of the settlement agreement but fail to consider how disagreements that may arise from its interpretation or implementation are to be resolved.

As a result, the original expectation of the parties that *all* disputes will be resolved through mediation or arbitration may not be realized if these procedures are not included in the settlement agreement.

Such a situation resulted recently in a matter before the Alaska Supreme Court in *SMJ General Construction v. Jet Commercial Construction* (440 P. 3rd. 210, 2019).

In May 2016, Jet had entered into a subcontract with SMJ “to supply the materials and labor for the construction of a restaurant building and improvements.” The contract further contained a requirement that any dispute arising under the contract must first be mediated; and, should the mediation be unsuccessful, the matter would be submitted to arbitration.

Several disputes arose during construction. In particular, SMJ claimed that Jet had violated the subcontract in several respects making it impossible for SMJ to satisfy its obligations.

Consequently, in accordance with the dispute resolution provisions in the subcontract, the matter was mediated. With the assistance of a professional mediator, the parties reached a three-paragraph, handwritten settlement agreement, which stated that it “reflects the essential and material terms of the parties’ agreement which will be followed by a more formal memorialization of same.”

The agreement provided, in effect, that Jet would pay SMJ $150,000, conditioned upon SMJ delivering to Jet within 30 days various fully executed releases and waivers. The agreement further provided that “Each party hereby absolutely releases the other of and from any and all claims, demands and obligations of any kind arising from contract of May 16.”

No “more formal memorialization” of the handwritten settlement agreement was ever prepared.

Soon thereafter, SMJ learned of actions by Jet that it claimed rendered impossible its ability to provide the waivers and releases called for by the agreement.

Consequently, SMJ filed a complaint in the Alaska courts alleging that the settlement agreement was null and void because of Jet’s fraud and misrepresentation, breach of covenant of good faith and fair dealing and negligence; and, accordingly, that it was entitled to a money judgment in the amount of $782,061.48.

Jet filed a motion to dismiss, claiming that the matter was not properly before the Alaska courts because of the subcontract’s dispute resolution provisions and requirement that any claim must be filed in Oklahoma.

SMJ countered that the parties could no longer rely on the subcontract's dispute resolution or forum selection provisions because they had been superseded by the settlement agreement.

The trial court, without explaining its reasons, granted the motion to dismiss and awarded attorney fees to Jet as the prevailing party. SMJ appealed.

In considering this matter, the Alaska Supreme Court declared that its responsibility was to determine whether the two contracts, the original subcontract and the settlement agreement, required that SMJ arbitrate its claims. It further noted that it was bound by several legal principles.

First, the Revised Uniform Arbitration Act, as codified in Alaska, provides that "the court shall decide whether an agreement to arbitrate exists or a controversy is subject to an agreement to arbitrate." (This same provision appears at Section 7321.7(b) of the Pennsylvania Revised Statutory Arbitration Act.) It further noted that this is consistent with the presumption under federal law that arbitrability is a question for the courts; and, this presumption may only be rebutted if the contract clearly provides otherwise, such as by stating that it is for the arbitrator to determine arbitrability.

With this in mind, the court noted that the although the subcontract did provide dispute resolution procedures (mediation to be followed by arbitration), it did not specifically mention how arbitrability was to be determined.

The court recognized, however, that the subcontract's dispute resolution procedures did provide for the initial submission of the mediation "pursuant to the Construction Industry Arbitration Rules and Mediation Procedures of the American Arbitration Association; and, that "the next step, arbitration 'shall be conducted pursuant to the same AAA Rules and procedures.'" Moreover, the AAA Rules did allow the arbitrator to determine arbitrability. These provisions, standing alone, therefore, supported Jet's claim that arbitrability was for an arbitrator and not for the courts.

Nonetheless, the court found that this intent as to arbitrability suggested by the subcontract could not be sustained because any such obligations under the subcontract had been explicitly released under the settlement agreement.

In reaching this conclusion, the court relied on basic principles of contract interpretation. First, when there are successive contracts addressing the same subject matter, “it is a well settled principle of law that the later contract supersedes the former contract as to inconsistent provisions.” Thus, the arbitrability provision contemplated under the subcontract could survive, but only if it was consistent with the terms of the later settlement agreement.

Here, although the subcontract does make reference to dispute resolution, the settlement agreement does not. Rather, the first paragraph of the settlement agreement states: “Each party hereby absolutely releases the other from any and all claims, demands and obligations of any kind arising from the contract of May 2016.”

The court further noted that it must interpret this settlement agreement as it would any other contract, by giving its words their ordinary, contemporary, common meaning unless they were otherwise defined. Here, the words of release, from “any and all claims demands and obligations arising from the subcontract” could hardly be broader.

Otherwise stated, the demand for arbitration by Jet, and any obligation of SMJ to participate, have no source other than the dispute resolution provisions of the subcontract. The settlement agreement’s plain language, however, makes clear that the parties were released from any such obligations arising under the subcontract.

In short, the language in the settlement contract was direct and unambiguous; and, as the New Jersey Superior Court had stated many years earlier in a similar case, “we cannot interpret this unambiguous language to mean anything other than that the original construction contract was to be regarded as history,” see *Borough of Atlantic Highlands v. Eagle Enterprises,* 711 A.2nd 407, 410 (1998).

Interestingly, the court further comments, this does not mean that arbitration may not ultimately be mandated in this case. Should the trial court, in later considering extrinsic evidence, agree with SMJ and set aside the settlement agreement as null and void, perhaps all of the parties' rights and obligations under the original subcontract, including those pertaining to dispute resolution might "revert to what they were under the subcontract." The court specifically notes, however, that it is not addressing that issue.

In summary, the dispute resolution issues in this case arose because the parties focused only on the substantive terms of their settlement without considering what procedures would be employed if the terms of the settlement agreement were later attacked in whole or in part. Such considerations would likely have been considered and included had a more formal settlement document been later prepared.

The moral, of course, is that in reaching any settlement, the collateral dispute resolution provisions must also be addressed in the settlement agreement by a specific statement reflecting whether the parties' obligations to resolve any further disputes through ADR survive. This will assure that the parties will be able to resolve any disputes arising out of it expeditiously and in accordance with expectations. •

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