Are the ADR Provisions in Your Contract and Subcontract Consistent?

Judge Abraham J. Gafni (Ret.)
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Contracts among owners, general contractors and subcontractors will invariably contain provisions detailing the forum and procedures under which their disputes are to be resolved. Of critical importance to the general contractor, of course, will be that these provisions be consistent. Otherwise, it may find itself arbitrating against the owner in in one jurisdiction while litigating its dispute with a subcontractor in court in another. This may result, of course, in significant additional expense and potentially inconsistent results.

Generally, avoidance of this risk is sought by the inclusion of a provision that incorporates the ADR provisions from the principal contract into the subcontract. When preparing such incorporation provisions, however, special care must be taken to assure that they are consistent, or, as reflected in a recent California Court of Appeal case, they may not be enforceable in the way the Contractor intended.

In *Remedial Construction Services* (subcontractor) *v. AECOM* (contractor), 65 Cal. App 5th 658, 279 Cal. Rptr. 3rd 909 (2021), the contractor had entered into a prime contract with Shell Oil Products US (owner). The contractor subsequently entered into a subcontract with the subcontractor. The subcontractor eventually filed suit against the contractor, claiming a failure to pay certain costs. The contractor responded by filing a motion to compel arbitration, asserting that the mandatory arbitration in the prime contract had been incorporated into the subcontract. The prime contract provision stated that "Any dispute or claim arising out of or in connection with the contract or its subject matter or formation, whether in tort, contract, under statute, or otherwise … will be finally and exclusively resolved by

arbitration" under the international dispute resolution procedures of the International Centre for Dispute Resolution.

The subcontract provided:

"The contract between the contractor and the owner … is hereby incorporated into and made a part of this agreement by reference. The subcontractor assumes toward the contractor all of the obligations and responsibilities contained in the prime agreement or client flow down provisions … that the contractor assumes toward its client as they relate to the subcontractor's performance of the work. In the event of a conflict between any provision of this agreement and the prime contract the more restrictive provision shall govern."

The trial court denied the contractor's motion to order arbitration as the subcontractor "did not agree to arbitrate its disputes with the contractor in the subcontract or to be bound by the obligation to arbitrate in the prime agreement … There is no general obligation in the subcontract and the subcontract does not directly incorporate an arbitration agreement from the prime agreement." Rather, the court found that the arbitration provision in the subcontract only applied to the contractor's claims or the subcontractor's claims against the owner, but not to claims between the contractor and subcontractor.

In agreeing with the trial court, the court of appeals noted the need for a clear agreement to submit disputes to arbitration, in the absence of which a waiver of the right to jury trial will not be inferred.

With respect to the incorporation of agreements to arbitrate, the court stated:

"While parties may incorporate by reference into their contract the terms of some other agreement … each case must turn on its facts. For the terms of another document to be incorporated into the document executed by the parties the reference must be clear and unequivocal, the reference must be called to the attention of the other party, and he must consent thereto, and the terms of the incorporated document must be known or easily available to the contracting parties."

The court of appeals cited five reasons for its refusal to enforce the contractor's attempt to arbitrate the subcontractor's claims:

- Under the incorporation clause, the subcontractor only assumed the contractor's responsibilities and obligation under the prime contract "to the extent they relate to [subcontractor's] performance of its work on the project." There was nothing in the subcontract, however, (in what the court emphasized was a 151-page document) to indicate that "this would include the subcontractor's and contractor's agreement to arbitrate their own disputes."
- The subcontract contained a provision giving precedence to the subcontract and its amendments as well the general conditions and drawings "over the prime contract should there be any conflict, variation or inconsistence between them." Thus, the parties "expressly agreed the terms of the subcontract would control over the prime agreement."
- The subcontract contained a litigation provision which stated: "Any litigation initiated by and between the parties arising out of or related to this subcontract shall be conducted in the federal or state court of jurisdiction in the state whose laws govern this subcontract and the contractor and subcontractor each consents to the jurisdiction of such court." In addition, the subcontract provided that "'in the event of any conflict, variation, or inconsistency between any provisions of the subcontract documents' which include the prime agreement, 'the provision of the more or most stringent requirement as the case may be shall govern.'"

Thus, as the court noted, “Since the subcontract upholds these rights by providing for litigation, its forum selection provision is the more restrictive and stringent and therefore controls the parties’ dispute.” Accepting the contractor’s interpretation of the subcontract would render the litigation provision “superfluous, void or inexplicable.” Moreover, “given the sophistication of the parties and the subject of the contracts, if an arbitration agreement were intended to cover all claims arising from performance of the subcontract or from the project, it would have been expected that an arbitration clause—or clause incorporating the arbitration clause of the prime agreement—would say so directly.”

- Force majeure provisions in the prime contract were specifically incorporated in the subcontract which had been drafted by the contractor. The court reasoned that if the arbitration provisions were intended to be similarly incorporated, the contractor would have included them as well. But, as the court stated, “to the extent an ambiguity exists regarding whether the contractor and subcontractor intended to arbitrate their disputes, it should be construed against the contractor as the party who caused the uncertainty to exist “
- There is a “joinder” provision in the subcontract which provides that if contractor is in arbitration, mediation or litigation with owner, and contractor determines that it would be appropriate, subcontractor shall consent to joinder to and a consolidated resolution of issues in that proceeding. This is the only time the subcontract even mentions arbitration. So, “it further confirms that if there was an intent to arbitrate claims relating to claims between the contractor and subcontractor, the subcontract would have so stated. The only agreement to arbitrate involving the subcontractor is one in which it is joined as a party to an action between contractor and owner.”

This opinion is perhaps unusual in that the court was able to identify numerous bases within the documents which supported its conclusion that incorporation of the arbitration provisions into the subcontract was not warranted. Of greater significance, however, is that it reflects why parties must give careful attention whenever a document seeks to incorporate provisions from other documents which impose obligations upon them.

Thus, as it might relate to arbitration, contractors should carefully review their subcontracts to assure that they do not contain provisions which conflict with the dispute resolution provisions in the principal contract. Indeed, rather than simply seeking to incorporate an arbitration provision by reference, contractors should clearly and unequivocally reference an arbitration provision in the subcontract itself.

Subcontractors, of course, must be equally concerned about provisions that impose contractual obligations relating to dispute resolution. In particular, they must carefully consider whether they are prepared to be subject to arbitration or mediation if the conditions relating to them, such as those relating to cost or location, are onerous. •

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