What Every Owner Should Know About Construction Law

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This article identifies and discusses a number of issues pertaining to the construction process, including how arbitrating construction disputes work.

All owners of real property or buildings of any sort—even those who are not engaged in the construction process on a regular basis—should have an understanding of certain fundamental issues related to the construction process. This article will identify and discuss a number of those issues.

What Does the Construction Contract Say?

The contract for construction between the owner and the general contractor is the single most important document in any construction dispute involving the owner. This contract is typically referred to as the general contract. The general contract establishes the rights and obligations of the most important parties on the construction project. While the owner's contract with the architect and the general contractor's subcontracts with its subcontractors can be significant, the general contract between the owner and the contractor provides the framework for everything that happens on the project and in the courtroom. In light of this, it is advisable for owners entering into general contracts to spend substantial time becoming familiar with the specific terms.

Most construction contracts incorporate by reference numerous additional contractual provisions known as "General Conditions." While some General Conditions are tailored to the particular construction project, in most cases the general contract will incorporate by reference American Institute of Architects Document A201-2007 ("A201"). Like most General Conditions, A201 contains many of the specific requirements which define the obligations of the owner and the general contractor. It is important to note that many clauses of A201 have been interpreted by the courts over the years. Certain law libraries have access to the AIA Citator Service, which provides the general practitioner with a helpful guide to the ways in which specific clauses found in AIA documents have been construed by courts and other triers of fact.

The general contract may also incorporate by reference certain "Special Conditions," plans and specifications. Special Conditions often involve technical requirements for the project, but may address any topic related to the project. The general contract will often incorporate certain plans and specifications pertaining to the project. Such plans and specifications are almost never attached to

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the general contract, so be sure to check the general contract's incorporation clause carefully to determine which additional documents may affect your client's rights and obligations.

Construction is a highly technical area of the law. Construction contracts contain voluminous clauses and subclauses. Moreover, there is typically more than one operative contract and the various contracts often form a confusing overlapping matrix of legal obligations.

What Does the Warranty Clause Say?

Many owners—even those who are involved in construction litigation on a regular basis—are confused by warranty clauses. Many owners believe that the presence of a warranty clause in a construction contract means that any claims regarding the workmanship on the project must be brought within one year of substantial completion of the project. This is not the case. In most construction contracts, the warranty clause simply states that the owner must notify the contractor of any nonconforming work within one year of substantial completion in order to trigger the contractor's obligation to make repairs without any additional cost to the owner. In most instances, the owner may assert a claim against the contractor for negligent, nonconforming or defective construction, or for cost overruns, at any time within the applicable statute of limitations.

Is There an Arbitration Clause?

One of the first things the owner must do is determine whether the construction contract in question contains an arbitration clause. Arbitration has long been the dispute resolution methodology of choice in the construction industry and most construction contracts contain an arbitration clause. Review the contract closely to see whether it contains such a clause. Even if an arbitration clause does not appear in the body of the construction contract, such a clause may have been incorporated by reference.

Unlike its 1997 predecessor, the 2007 edition of the AIA A201 General Conditions does not automatically require the owner to engage in arbitration in order to resolve a construction dispute. Section 15 of A201 establishes a process pursuant to which claims are first submitted to an Initial Decision Maker (typically, but not always, the architect) for resolution. The decision of the Initial Decision Maker is final, but is subject to mediation if one of the parties disagrees with the decision. If the parties cannot resolve the dispute in mediation, the parties then submit the dispute to binding dispute resolution. Binding dispute resolution may be either arbitration or litigation, at the option of the parties.

How Will the Arbitration Proceed?

If the parties select arbitration as their binding dispute resolution methodology, A201 states that the arbitration will be conducted pursuant to the Construction Industry Arbitration Rules of the American Arbitration Association (the "Rules"). The procedures applicable in an arbitration conducted by the American Arbitration Association ("AAA") are outlined in the Rules. A copy of the Rules can be obtained online or from any AAA office. The rules themselves are self-explanatory, but be sure to note a number of specific features of such an arbitration.

Each case will be placed in one of three categories by the AAA, depending on the amount of money in dispute. If a case involves a dispute in which no claim or counterclaim exceeds $75,000, the AAA's Fast Track

procedures will apply. If a case involves a dispute in which the claim or counterclaim of any party is $500,000 or more, the Large, Complex Track procedures will apply. All other cases are designated as Regular Track cases.

The classification of each case will determine the procedures to be followed. In all cases, the arbitration is commenced by the filing of a one-page form called a Demand for Arbitration by the Claimant. At the time the Demand for Arbitration is filed, the claimant must pay the AAA a non-refundable filing fee. The filing fee ranges from $775 to $65,000, depending on the amount of money in controversy.

The respondent is given an opportunity to file a written response, but is not required to do so. The AAA office administering the arbitration will then send each party a list of potential arbitrators. Each party is allowed to strike certain arbitrators from the list on a peremptory basis. In a single arbitrator case, each party may strike up to three names. In multiple arbitrator cases, each party may strike five names. The AAA will then appoint the arbitrator (or arbitrators) from the remaining names on the list. Fast Track and Regular Track cases are decided by a single arbitrator, unless the parties have provided otherwise in the arbitration agreement. In Large, Complex Track cases, a single arbitrator will be used unless one of the parties objects. If one party to a Large, Complex Track case objects to the use of a single arbitrator, three arbitrators will be used.

The parties are responsible for the fees of the arbitrators. Arbitrator fees varies widely depending upon the geographic location of the arbitrator, but in most major metropolitan areas, arbitrators charge anywhere from $1,500 to $4,000 per day.

After the arbitrator is appointed, the arbitrator may hold a pre-hearing conference (either in person or by telephone) to discuss the logistics and administrative issues associated with the arbitration. Such a conference is required in Fast Track cases. In Large, Complex Track cases, the AAA will conduct an administrative hearing.

Unless specifically provided for in the arbitration agreement, no formal discovery is conducted prior to the hearing. The AAA rules give the arbitrators discretion to require the pre-hearing exchange of documents and witness lists. The parties may request additional pre-hearing discovery, but such a decision is completely within the discretion of the arbitrators. If your claim involves less than $10,000, the claim can be resolved on the basis of documents alone (so long as neither party requests a hearing).

At the hearing, each side is allowed to present its evidence and to cross examine adverse witnesses. It is important to note, however, that rules of law (including rules of evidence) typically do not apply. This invariably results in the admission of a wide array of evidence, only some of it credible.

Upon completion of the hearing, the arbitrator's award must be issued (1) within 30 days of the close of the hearing in Regular Track and Large, Complex Track cases and (2) within seven days in Fast Track cases. In the absence of fraud or some other egregious conduct, the award is not subject to appeal. While parties regularly seek the award of costs and attorney's fees in arbitration, arbitrators seldom award such fees.

Finally, it is important to note that the arbitrator's award is binding and not generally subject to appeal. With the exception of a few narrowly defined situations (such as

arbitrator corruption, misconduct or manifest disregard of the law), courts almost always decline to alter or vacate the arbitrator's award. If you agree to binding arbitration, the arbitrator's decision will almost certainly be the final word on your dispute.

Can the Architect Be Brought into the Fray?

On most construction projects, the architect has a separate contract with the owner. This document is often an AIA Document B141-1997 ("B141"). If left unmodified, B141 contains a clause which prohibits the owner from adding the architect as a party to an arbitration between the owner and the contractor. While this is good news for the architect, it can often produce duplicative proceedings and inconsistent results. If, for example, the contractor brings a claim against the owner in arbitration, the architect cannot be made a party to the arbitration unless the architect agrees to participate as a party. Even if the contractor's primary complaint is the performance of the architect, the absence of a contract between the architect and the contractor forces the contractor to proceed against the owner rather than the architect. In such a case, the contractor argues that the owner is liable for damages caused by its agent, the architect. While the foregoing contracts do not prohibit the architect from consenting to being added to the arbitration as a party, this happens about as often as the Chicago Cubs win the World Series.

Is the Project a Bonded Project?

Most construction contracts require the contractor to provide performance and payment bonds. A performance bond is a separate contract in which the surety promises the owner that the work described in the general contract between the owner and the contractor will be performed—either by the original contractor, the surety or a substitute contractor. In a payment bond, the surety promises that the subcontractors and materialmen who have contracted with the general contractor will be paid for their services and materials. The surety company which issues the bonds can be a useful partner in the search for resolution of a construction dispute. It is in the surety's interests for the contractor to meet all of its obligations and complete the project in accordance with the contract documents. When a construction dispute arises prior to the completion of the construction project, the surety can be a valuable asset in fashioning a settlement. The contractor is much more likely to listen to his or her surety (who often controls the contractor's ability to work) than to the owner or of the architect. Bring the surety into the case at an early stage to increase your chances of resolving the dispute.