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Construction vs. Design: Sorting Out Claims Involving Multiple Parties and Contracts

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This article discusses the issues which arise in the context of a construction dispute when there are numerous related contracts and multiple parties, and when one of the contracts, to which the other parties may not be privy, calls for mandatory arbitration. The article describes the risk and reality of potentially inconsistent findings and conflicting results, in the midst of a multiplicity of proceedings.

The construction industry has many different players, and is characterized by a complex and broad web of business and legal relationships. A typical large project could involve one or more owners, design professionals, sub-consultants, lenders, quantity surveyors, project managers, general contractors, subcontractors, material suppliers, insurers, sureties, and others. What this tends to mean is that construction claims and disputes are somewhat unique, and very often involve multiple contracts, subcontracts and service agreements, and multiple parties, when some of these contracts might not contain an arbitration clause.

In many cases, we hear contractors defensively state that they are not responsible for the owner's claim -- it is not a "construction" issue, they might say, but rather relates strictly to "design." The engineer might retort that the design and the contract administration were just fine, but it was the contractor who did not perform his work properly.

An anecdote: An arbitrator was selected to arbitrate a dispute between an owner and his engineer. The evidence convinced the arbitrator that the problems were construction-related, not design-related, and he therefore ruled for the engineer. Unbeknownst to him, though, there had been a prior arbitration between the same owner and the contractor on the project, in which the previous arbitrator determined that the problems were design-related, and ruled for the contractor. As a result of these two awards, the owner recovered nothing. While there is a remote chance of that outcome if all parties had participated in a single proceeding (for example the arbitrator could have found that the contractor had not breached

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the contract, and that the engineer had not breached the professional services agreement or the applicable standard of care), there is certainly less risk of inconsistent results if there is a single proceeding.

This raises the issue as to how a two-party or bilateral dispute resolution provision in a construction contract can reel in and engage the other players, like the subcontractor and the design professional. The challenge is further compounded by the fact that subcontractors have their own sub-subcontractors and suppliers, and prime consultants often engage the services of sub-consultants, such as geotechnical, structural and mechanical/electrical engineers.

Most arbitration clauses are drafted with only two parties in mind. There are many circumstances, however, when a dispute concerns numerous parties or arises out of several separate contracts. Multi-party/multi-contract disputes can occur when, for example, several parties have participated in a joint venture; or where one party enters into numerous contracts to construct or finance a project; or when an owner enters into a general contract with a contractor who subcontracts parts of the work to various subcontractors. As evidenced by the anecdote set out above, insofar as arbitration proceedings are concerned, this gives rise to a real risk of concurrent or consecutive proceedings, with the attendant costs and the risk of inconsistent determinations and conflicting results.

This dilemma might be avoided if arbitration clauses were drafted to clearly permit (i) the "*joinder*" of voluntary and consenting non-signatories as additional parties to the arbitration proceeding, and (ii) the "*intervention*" of consenting non-signatories in the single arbitration process. Consent of all parties is pivotal to these options.

Alternatively, the arbitration clauses in both or all related contracts could have been drafted so as to contemplate the prospect of a "*consolidation*" of the different sets of proceedings.

These suggestions create challenges. For example, there may be challenges with respect to the nomination of a single arbitral tribunal; the compatibility of dispute resolution terms (such as the seat, governing law, rules, and scope of discovery). Some of these challenges may either be addressed by the rules of the institutional alternative dispute resolution service providers, or by the collaboration of the parties (such as by the parties agreeing to incorporate the same arbitration clause by express reference into each individual contract).

In the United States, federal courts recognize no less than five theories -- agency, assumption, estoppel, alter ego and incorporation[1] -- pursuant to which an arbitration clause may be enforced by or against a

[1] See Carl F. Ingwalson, Jr., Adam T. Mow, and Elysian Kurnik, "*Arbitration and Nonsignatories: Bound or Not Bound*" (Winter 2012) Journal of the American College of Construction Lawyers (Vol. 6, No. 1) at p. 1

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non-signatory. Some of these involve "incorporation-by-reference" and "flow-down" clauses, which are often found in construction contracts.

In Canada, however, the simple answer is that there may be no simple answer.

For instance, Sunny Corner Enterprises Inc. v. Dustex Corporation et al[2] *is a 2011 decision of Chief Justice Kennedy of the* Supreme Court of Nova Scotia. In that case, the arbitration clause in the general contract required that any dispute between the owner and the contractor be resolved by arbitration. A subcontractor's purchase order stated that the scope of the subcontract work was to be as defined in the general contract. An issue arose as to whether the arbitration clause in the general contract was incorporated by reference into the subcontractor's purchase order. The court held that an arbitration clause in a general contract will only be incorporated into a subcontract if it is *specifically* so incorporated. The court also referred to *Dynatec Mining Ltd. v. PCL Civil Constructors (Canada) Inc.*,[3] a 1996 decision of Madam Justice Chapnik of the Supreme Court of Ontario (as it then was), in which she held that "[i]*ncorporation of an arbitration clause can only be accomplished by distinct and specific words . . .*".[4]

Accordingly, in the context of an arbitration proceeding in Canada, the arbitrator has no authority to add parties who are not privy to an agreement to submit their disputes to arbitration. As a result, a battle may have to be waged concurrently or consecutively on several different fronts.

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for a comprehensive discussion of circumstances in which non-signatories to an arbitration agreement may nonetheless be compelled to arbitrate.

[2] 2011 NSSC 172

[3] (1996), 25 C.L.R. (2d) 259, 1996 CarswellOnt 16 (Ont. C.J. (Gen. Div.))

[4] *ibid*, at para. 11

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