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Careful Drafting Can Prevent Dispute Clauses from Being Ignored [Ober|Kaler]

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Two recent cases highlight the pitfalls facing construction parties -- owners, contractors and subcontractors -- when they use fairly common contract clauses that address how they want disputes decided. In one case, the clause gave one side the unilateral right to choose if disputes go to arbitration or court. In another case, the clause said that disputes could only be filed in state or federal court in Virginia. In both cases, one of the parties to the contract ignored the agreed clause and started a lawsuit in a forum different than what the contract required. In both cases, however, the court refused to enforce the clause.

In the first case, *Noori v. Toll Bros., Inc.*[1], the U.S. Court of Appeals for the Fourth Circuit refused to enforce a unilateral arbitration clause in contracts between the builder and several buyers of custom houses in Maryland. The arbitration clause stated that only the buyers had to submit their disputes to arbitration. The buyers, instead, filed suit in federal court in Maryland.

The Fourth Circuit Court refused to enforce the arbitration clause. The Court said that, under Maryland law, an arbitration clause is a severable agreement, even when it is part of a larger contract. As a severable agreement, it must bind both parties and be supported by consideration independent of the contract, namely, mutual obligation. An arbitration clause that binds only one party, or gives the other party the unilateral right to decide whether to require arbitration or litigation in court, is not enforceable under Maryland law. Importantly, it did not matter to the Court whether the Federal Arbitration Act applied. The Court refused to say that the FAA preempted the Maryland rule.

In short, because the arbitration clause was one-sided in favor of the builder, it was not enforceable. So the buyers were permitted to sue the builder in court.

The second case, *In re Atlantic Marine Constr. Co.*[2], involved a construction project for the U.S. Army Corps of Engineers in Texas. The prime contractor, Atlantic Marine, is a Virginia company, with its headquarters in Norfolk, Virginia. It subcontracted with J-Crew Management, a Texas company. The subcontract had a forum selection clause that required all disputes to be resolved in either state or federal court in Norfolk, Virginia. Ignoring the forum selection clause, the subcontractor sued in federal court in its hometown, Austin, Texas. Atlantic Marine filed a motion to dismiss or transfer the case to federal court in Virginia. The district court denied the motion, stating that Atlantic Marine failed to show the balance of factors (convenience of the parties, interests of justice, etc.) favored Virginia.

Atlantic Marine then appealed to the federal court of appeals for the Fifth Circuit. Atlantic Marine argued that the parties agreed to where the dispute gets resolved via their forum selection clause; and that this clause trumps the other considerations. The Court denied the appeal. There were two key facts according to the Court. First, the forum selection clause involved federal court venue, as opposed to state or foreign court, or arbitration. Second, the clause selected the forum for dispute resolution but did not have a choice of law provision.

Applying federal law, the Court said that private parties can deprive a federal court of venue only in limited cases. Because of the language of this clause, the trial court had the discretion to consider the other factors. In addition, it was the moving party's burden to show the factors tilted in favor of the other federal court.

A concurring opinion noted that the federal circuits were not in agreement on the enforceability of a forum selection clause involving federal courts. It invited Atlantic Marine to ask the U.S. Supreme Court to take the case. On April 1, 2013, the Supreme Court granted certiorari, meaning it will take the appeal.

The last thing people in the construction industry want is to have their dispute litigated all the way to the Supreme Court, especially over a procedural issue like where the dispute gets decided. The lesson of these cases is that, to avoid having your matter end up in the Supreme Court, more careful drafting is needed. Looking first at the arbitration clause issue, the clause needs to be either mandatory on both parties, or created as a separate contract with its own consideration. I suspect that it may suffice for the arbitration agreement to recite and pay $10 as consideration to Party A in order to give Party B the sole right to elect arbitration.

In the second situation, involving forum selection, one needs both a choice of forum clause and a choice of law clause. The drafter should be aware of how the law will apply and draft the contract to match the parties' agreement. Otherwise, more money will be spent fighting over where to hold the dispute than in resolving the dispute itself.

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[1] U.S. Ct. App., No. 12-1261 (4th Cir., 2/26/13).

[2] 701 F.3d 736 (5th Cir. 2012), cert. granted (No. 12-929, 4/1/13).