

ENFORCING ARBITRATION IN CONSTRUCTION DEFECT LITIGATION

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An often overlooked provision in a building contract is the alternative dispute resolution paragraph. Arbitration provisions in contracts never become important until a dispute over the subject matter of the contract arises. Oftentimes when the dispute arises, it may be too late to enforce an arbitration agreement if the arbitration provision is deficient, not properly executed, or if the proper documentation is not available to prove that the parties agreed to arbitrate.

This article will discuss why arbitration provisions can be very important

in the construction setting and the best ways to ensure that an agreement to arbitrate is enforceable. Next the article will delve into a discussion of the Georgia Arbitration Act¹ and the Federal Arbitration Act². Finally, there will be a discussion of the principle of equitable estoppel, which can be used to compel a plaintiff's claims against nonsignatories to an arbitration agreement to arbitration.

I. WHY ALL THE FUSS?

For any practitioner who has conducted *voir dire* in a construction defect case (particularly a *residential* construction defect case), the answer to this question is obvious (and most likely "Duh!"). Jurors do not like contractors. Jurors do not trust contractors. Furthermore, while defense attorneys in civil litigation generally prefer educated, working homeowners to serve as jurors for their cases, in construction defect litigation those are the people who, more likely than not, have had a bad experience with a builder. Contractors charged with defending against a claim of alleged construction defects in a residential setting come in as 56 point underdogs – while playing without their starting quarterback!

Arbitrators, on the other hand, are generally very knowledgeable about construction issues and have a realistic approach to what is truly defective and what is not defective. Thus, while they ultimately may find for the plaintiffs on

some of their claims, it will not be based upon an unfair bias or stereotype. Furthermore, arbitrators, unlike most jurors, will be able to separate the wheat from the chaff – the chaff being the often petty and emotional squabbles between the builder and the homeowner.

Furthermore, some posit that arbitration is less costly. While this is generally true because the case will not usually linger in discovery for several years, arbitration is far from cheap – discovery will have to be conducted, and, depending on the case, the arbitration itself could take several days or even weeks. Nevertheless, as a general rule, arbitration, while not inexpensive, usually is less expensive and quicker to a resolution than the traditional civil jury trial route.

Finally, arbitration usually avoids the extremes of jury trials – runaway verdicts and outright defense verdicts. While most practitioners have experienced some outright defense verdicts in construction arbitrations, it is usually not the norm, as most of the time a homeowner will have at least one legitimate claim. On the other hand, and more importantly, there are no “runaway verdicts” in arbitration for the homeowners. Typically, a homeowner will have an incredibly long list of alleged defects in addition to claims for breach of contract, breach of warranty, fraud, deceit, misrepresentation, unjust enrichment, equitable rescission, diminution of value, loss of use and attorney’s fees, etc. The dollar value placed upon all such claims by counsel for the homeowner usually exceeds the value of the home itself. While the wrong jury might give plaintiff everything under the sun, an arbitrator (who is selected with input from defense counsel) will almost

never do so. Further, counsel for the homeowner will most likely have a claim for exorbitant attorney’s fees which will invariably be requested in addition to the homeowner’s damages. A carefully crafted arbitration agreement will eliminate such exposure.

II. HOW TO ENSURE THAT THE ARBITRATION CLAUSE IS VALID

a. The Purchase and Sale Agreement

Typically, the standard Purchase and Sale Agreement issued by the Georgia Association of Realtors will have a provision for the arbitration of disputes. However, not all purchase and sale agreements contain such a provision and those that do contain such a provision have language which indicates that the provision is not enforceable unless initialed by both parties. In closings, the initialing of the arbitration provision is often overlooked – many times to the chagrin of the builder when it is sued for alleged construction defects. Typical arbitration provisions provide as follows:

Buyer and Seller agree that any construction defect claim not resolved after following the procedure in O.C.G.A. § 8-2-38 and all other claims between the parties shall be settled by arbitration through the services of an arbitrator mutually agreed upon by the parties. The decision of the arbitrator shall be final and may be enforced by any court having jurisdiction thereof. The arbitration shall be conducted

in accordance with O.C.G.A. § 9-9-1 et seq. Notwithstanding the provisions of this subparagraph, if Buyer is claiming under a warranty provided by Seller, the terms and procedures of that warranty shall first apply to the resolution of the claim. **In order for this paragraph to be part of this Agreement it must be initialed by Buyer and Seller; if not initialed it shall be void and unenforceable.** (emphasis added).

The requirement that the agreement to arbitrate be initialed by both parties is mandated by O.C.G.A. § 9-9-2 (c) (8) which provides as follows:

(c) This part shall apply to all disputes in which the parties thereto have agreed in writing to arbitrate and shall provide the exclusive means by which agreements to arbitrate disputes can be enforced, except the following, to which this part shall not apply:

...

(8) Any sales agreement or loan agreement for the purchase or financing of residential real estate unless the clause agreeing to arbitrate is initialed by all signatories at the time of the execution of the agreement. This exception shall not restrict agreements between or among

real estate brokers or agents;

Accordingly, because this language must be included in order to compel arbitration under the Georgia Arbitration Act³, it is crucial for builders to insure that both they AND the homeowners initial this paragraph.

b. The Warranty

The sample arbitration provision cited above from a typical Purchase and Sale Agreement also incorporates and references a 2-10 Home Buyers Warranty. If the homeowners have initialed the arbitration provision and the homeowners have signed a typical 2-10 Warranty Application, enforcing arbitration is that much easier for a builder. The typical Warranty Application indicates that by signing the Warranty Application, homeowners acknowledged that they have "read a sample copy of the Warranty Booklet, and CONSENT TO THE TERMS OF THESE DOCUMENTS INCLUDING THE BINDING ARBITRATION PROVISION contained therein."

The typical 2-10 Warranty Booklet contains a broad arbitration clause wherein the parties agree as follows:

ARBITRATION Any and all claims, disputes and controversies by or between the Homeowner [and] the Builder . . . arising from or related to this Warranty, to the subject Home, to any defect in or to the subject Home or the real property on which the subject Home is situated . . . including without limita-

tion, any claim of breach of contract, negligent or intentional misrepresentation or nondisclosure in the inducement, execution or performance of any contract, including the arbitration agreement, and breach of any alleged duty of good faith and fair dealing, shall be submitted to arbitration

Moreover, the typical 2-10 Warranty arbitration agreement goes on to state that “[a]ny disputes concerning the interpretation or enforceability of this arbitration agreement, including without limitation, its revocability or voidability for any cause, the scope of arbitrable issues, and any defense based on waiver, estoppel or laches, shall be decided by the arbitrator.” Furthermore, the arbitration agreement typically expressly states that the parties agree that the Warranty and arbitration agreement “involve and concern interstate commerce and are governed by the provisions of the Federal Arbitration Act (9 U.S.C. § 1, et seq.).”

This is important because the Federal Arbitration Act is much broader than the Georgia Arbitration Act and does not require the parties to initial the arbitration clause in the Warranty.

III. ARBITRATION STATUTES

a. The Georgia Arbitration Act

In 1988 the Georgia General Assembly enacted the current Georgia Arbitration Code (hereinafter “GAC”). The enactment of this Act by the Georgia General Assembly established “a clear

public policy in favor of arbitration” in this state. Witherington v. Adkins.⁴ “Georgia courts are required to uphold valid arbitration provisions in contracts.” Saturna v. Bickley Constr. Co.⁵

Georgia Code section 9-9-3 provides in pertinent part:

A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit any controversy thereafter arising to arbitration is enforceable without regard to the justiciable character of a controversy and confers jurisdiction on the court of the state to enforce it and to enter judgment on an award.

The GAC further states that the court “**shall**” order the parties to arbitrate “[i]f the court determines there is no substantial issue concerning the validity of the agreement to submit to arbitration” O.C.G.A. § 9-9-6(a) (emphasis supplied). Moreover, broad arbitration clauses which apply to all claims between parties are enforceable. See D.S. Ameri Constr. Corp. v. Simpson.⁶

When the language of the arbitration clause is broad enough to encompass “all claims”, Georgia courts have no jurisdiction over the subject matter of the claims except for confirmation of an arbitration award. See LaSonde v. Citi-Financial Mortgage Co.⁷ (upholding trial court’s dismissal of case where all of the causes of actions against the defendant were compelled to arbitration, and there was nothing left for the trial court to resolve).

b. The Federal Arbitration Act

The Federal Arbitration Act (“FAA”), 9 U.S.C.A. §§ 1 *et. seq.*, is much more broad and much easier to enforce. Thus, offering a 2-10 Warranty can be of great benefit to a builder. The typical arbitration agreement contained within the Warranty provides that the parties expressly agree that the arbitration agreement involves and concerns interstate commerce and that the agreement is governed by the FAA.

The FAA provides in relevant part that “[a] written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof . . . shall be valid, irrevocable, and enforceable.” 9 U.S.C. § 2. Under the FAA, “[a]ny doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.” Wise v. Tidal Constr. Co.⁸

Broad arbitration clauses which apply to all claims between the parties are enforceable and encompass claims that an entire contract should be rescinded due to fraud. See Harrison v. Eberhardt,⁹ (analyzing identical arbitration language from a 2-10 Home Buyers Warranty and finding that all of the plaintiff’s claims were subject to arbitration even though the plaintiff did not bring her claims under the Home Buyers Warranty); Wise v. Tidal Constr. Co.,¹⁰ (finding broad arbitration agreement in 2-10 Home Buyers Warranty applied to all of the plaintiffs’ claims, including

their breach of contract and negligence claims); Bennet v. Cotton,¹¹ (upholding broad arbitration clause and finding

same applied to claims for fraud and deceit); see also Prima Paint Corp. v. Conklin Mfg. Co.,¹² (finding fraud in the inducement claim was an issue for the arbitrator to decide; not an issue for the trial court).

c. Major Differences Between the GAA and the FAA

The first and most significant difference between the Federal Act and the Georgia Act is that in Georgia, a potential plaintiff cannot be forced to arbitrate “future claims arising out of personal bodily injury or wrongful death based on tort.” O.C.G.A. § 9-9-2 (c) (10). The Federal Act has no such limitation. Thus, if the arbitration clause is drafted carefully and broadly enough, even claims for personal injury against the builder will be subject to arbitration if the agreement specifies that the FAA shall apply. This will help tremendously in the ever popular mold injury claims against builders.

The second significant difference is the fact that arbitration agreements under the Georgia Act are not enforceable unless all parties have initialed the arbitration provision. O.C.G.A. § 9-9-2 (c) (8). Under the FAA, there is no requirement that the paragraph which contains the agreement to arbitrate be initialed. Thus, so long as the agreement itself is signed by the parties, the claims listed in the arbitration provision must be resolved through arbitration.

IV. ENFORCING ARBITRATION FOR SPECIFIC CLAIMS

a. Claims for Attorney's Fees

Claims for attorney's fees can be a major issue for even minor construction defect disputes. For example, assume a homeowner has alleged approximately \$30,000 in construction defects and efforts to resolve with the builder have failed. The homeowner then hires an attorney who bills at the rate of \$300 per hour. The attorney tries to negotiate a resolution with the builder with no success – 10 hours of time. Next, the attorney tries to negotiate with an adjuster with the builder's general liability insurance carrier with no success – 10 hours of time. Accordingly, the attorney files suit, initiates discovery, takes depositions etc. – 50 hours of time. Further assume that defense counsel, through discovery, is able to convince the plaintiffs and their attorney that their defect claims are really only worth \$15,000. However, the plaintiffs have incurred \$21,000 in attorney's fees and have made a claim for same in their lawsuit. They now want \$36,000 to settle and they are willing to take their chances with a jury, most of whom will hate the builder and may very well award attorney's fees. A well drafted arbitration provision can eliminate any potential for recovery of such fees.

In Hope & Associates, Inc. v. Marvin M. Black Company,¹³ the Georgia Court of Appeals held that in an arbitration setting, attorney's fees are a matter of contract. Thus, the parties can decide in the contract whether or not attorney's fees are recoverable by the prevailing party.¹⁴

First the Court held that "In Georgia, attorney[s] fees are recoverable only when authorized *by statute or by contract.*"¹⁵ The court then noted that there is no statute specifically authorizing attorney's fees in arbitration proceedings.¹⁶ However, the parties in Hope & Associates did agree in the contract that the prevailing party would be entitled to an award of attorney's fees.¹⁷ Thus, the Court upheld this award.¹⁸

More importantly, however, is the language in the Court's holding where it stated that:

If the parties contract for attorney's fees, that agreement will be enforced. If the parties do not contract for attorney's fees, **each party will be responsible for the payment of his own attorney's fees.**¹⁹

Furthermore, absent a specific agreement for the payment of attorney's fees, the homeowner still cannot win an award of fees pursuant to O.C.G.A. § 13-6-11. See Walton Acoustics v. Currahee Constr. Co.²⁰

Under the FAA, the issue of an award of attorney's fees is likewise a matter of contract and absent statutory authorization or contractual agreement, the normal American rule for attorney's fees would apply. See, e.g. Menke v. Monchecourt.²¹

Some builders will balk at not having a provision to recoup their attorney's fees should a homeowner file for arbitration against them. However, as can be seen from the example above, a provision in an arbitration agreement

for the prevailing party to recover attorney's fees has costs which are simply outweighed by the benefits.

b. Are Claims for Rescission and/or Fraud in the Inducement Subject to Arbitration?

The Court of Appeals answered this question in the affirmative in the case of Harrison v. Eberhardt.²² In Harrison, a homeowner filed suit against her builder alleging that she had been fraudulently induced to purchase the property and sought rescission of the purchase and sale agreement. Harrison.²³ In the process of purchasing her home, the homebuyer signed a document acknowledging and consenting to the terms of a 2-10 Home Buyers Warranty.²⁴ This document expressly noted that the warranty included a binding arbitration provision.²⁵ The plaintiff did not bring her suit under the warranty, but instead instigated the action on the basis of the purchase and sale agreement for the property.²⁶ The builder moved to compel arbitration under the arbitration clause contained within the 2-10 Home Buyers Warranty.²⁷ The Court of Appeals relied on Wise v. Tidal Constr. Co.²⁸ and found that the language of the broad arbitration agreement was enforceable under the FAA, and that it encompassed the plaintiff's claim for fraudulent inducement.²⁹

Thus, when a typical 2-10 Warranty is provided, even claims for fraud in the inducement and equitable rescission will be subject to arbitration. However, what about cases where a 2-10 Warranty is not provided? Fortunately, the Court of Appeals recently answered this question in the affirmative in the recent case of Order Homes, LLC v. Iverson et. al.³⁰

In Iverson, Allen "The Answer" Iverson and his wife, Tawanna, filed suit in the Superior Court of Fulton County against their homebuilder and several other sub-contractors, individuals and other entities, asserting claims for fraud, deceit, misrepresentation, negligent hire, continuing nuisance, strict products liability, unjust enrichment, and violation of the Uniform Deceptive Trade Practices Act.³¹

The builder, its principals, the builder's related companies and their principals moved to compel arbitration pursuant to the arbitration provision contained within the Purchase and Sale Agreement (a GAR standard contract).³² The arbitration provision at issue provided as follows:

Buyer and Seller agree that any construction defect claim not resolved after following the procedure in O.C.G.A. § 8-2-38 and **all other claims between the parties shall be settled by arbitration** through the services of an arbitrator mutually agreed upon by the parties. The decision of the arbitrator shall be final and may be enforced by any court having jurisdiction thereof. The arbitration shall be conducted in accordance with O.C.G.A. § 9-9-1 et seq. Notwithstanding the provisions of this subparagraph, if Buyer is claiming under a warranty provided by Seller, the terms and procedures of that warranty shall first apply to the resolution of the claim. In

order for this paragraph to be part of this Agreement it must be initialed by Buyer and Seller; if not initialed it shall be void and unenforceable. (emphasis added).

The Iversons attempted to avoid the binding arbitration provision in several ways. First, they argued that despite the broad language quoted above, claims for equitable rescission and/or fraud in the inducement could not be subject to arbitration because, if successful, the Purchase & Sale Agreement would be void *ab initio* and, thus, there would not be any arbitration agreement for the Court to enforce.³³

In support of their argument in this regard, the Iversons cited the case of D.S. Ameri Construction Corporation v. Simpson.³⁴ In Simpson, the arbitration clause at issue provided as follows:

Any unresolved claims or dispute between Seller and Buyer arising out of or relating to such warranty, if any, and any other claim or dispute of any kind or nature between Seller and Buyer arising out of or relating in any manner to this Agreement or this transaction shall be decided by binding arbitration.... The provisions of this paragraph shall survive closing and delivery of the warranty deed to Buyer and *shall apply to any claim for rescission of the Agreement*. Any questions regarding the interpretation of this arbitration

provision or about the arbitrability of a dispute under this provision shall be decided by the arbitrator, unless specifically required by law to be decided by a court, and shall be binding on the parties.³⁵

Furthermore, the Iversons asserted a count under the Fair Business Practices Act which was done for only one transparent reason – to attempt to get around the arbitration provision of the contract.³⁶ O.C.G.A. § 9-9-2 (c) (7) provides that claims for “[a]ny contract involving consumer acts or practices or involving consumer transactions as such terms are defined in subsection (a) of Code Section 10-1-392, relating to definitions in the “Fair Business Practices Act of 1975” are not required to be arbitrated. Thus, the Iversons attempted to characterize the purchase and sale of their home as a “consumer transaction” based upon the fact that O.C.G.A. § 10-1-392 (a) (10) defined “consumer transactions” to include “the sale, purchase, lease, or rental of goods, services, or property, real or personal, primarily for personal, family, or household purposes.”

Surprisingly, the trial court judge agreed with the Iverson’s logic on this. Fortunately, however, the Court of Appeals reversed on this issue and held that the contract language was unambiguous and that the intent to arbitrate not only construction defect claims but also “all other claims between the parties” was clear and enforceable, including claims for fraud in the inducement and equitable rescission and under the Fair Business Practices Act (“FBPA”).³⁷ As to the definition of “consumer transactions” in the FBPA, the Court noted that the *general* exception to consumer

transactions in the GAC does not override the specific inclusion of an agreement for the construction of a new home if the arbitration clause is initialed. O.C.G.A. § 9-9-2 (c) (8).³⁸

IV. EQUITABLE ESTOPPEL

The final way that the Iversons tried to avoid arbitration was by suing other entities and individuals related to the builder but who had not signed the arbitration agreement.³⁹ Thus, plaintiffs argued that their claims against non-signatories to the arbitration agreement should be allowed to proceed to a jury trial. The trial court agreed and again the Court of Appeals reversed.⁴⁰

The Court of Appeals held that the trial court committed error by refusing to apply the doctrine of equitable estoppel and not allowing non-signatory Defendants to compel Plaintiffs' claims against them to arbitration.⁴¹ In so holding, the Court of Appeals noted that it has repeatedly held that a non-signatory defendant may enforce an arbitration agreement against a signatory plaintiff.⁴² *see, e.g., Price v. Ernst & Young, LLP*,⁴³ (applying equitable estoppel and finding a non-signatory may compel a signatory plaintiff to arbitration); *AutoNation Fin. Serv. Corp. v. Arain*,⁴⁴ (equitably estopping signatory party from asserting non-signatory could not enforce arbitration clause) (physical precedent only); *Paine, Webber, Jackson & Curtis, Inc. v. McNeal*,⁴⁵ ("If arbitration defenses could be foreclosed simply by adding as a defendant a person not a party to an arbitration agreement, the utility of such agreements would be seriously compromised").

The Court of Appeals first adopted the equitable estoppel doctrine in *AutoNation Financial Services Corporation v. Arain*,⁴⁶ (physical precedent only). Since the *Arain* opinion was issued, it has been relied upon and cited on multiple occasions with approval.⁴⁷ In *Arian*, a non-signatory finance company sought to enforce the arbitration provision contained in an installment contract and compel the plaintiff's RICO claims to arbitration.⁴⁸ The court determined that the FAA governed the dispute.⁴⁹ On the appeal of the trial court's denial of the non-signatory defendant's motion to compel arbitration, the Court held that the plaintiff was equitably estopped from asserting that the non-signatory finance company cannot enforce the arbitration clause.⁵⁰

The Court of Appeals has considered several factors for applying equitable estoppel, including the potential for conflicting decisions if a non-signatory is not brought to arbitration, the status of the parties as joint tortfeasors, and the relationship of the claims to the arbitration contract.⁵¹ Prior to the *Iverson* case, the Court cited to the Eleventh Circuit and noted two different circumstances where equitable estoppel allows a non-signatory to compel arbitration: 1) "when the signatory to written agreement containing an arbitration clause must rely on the terms of the written agreement in asserting its claims against the non-signatory" or 2) "when the signatory to the contract containing the arbitration clause raises allegations of substantially interdependent and concerted misconduct by both the non-signatory and one or more of the signatories to the contract."⁵² The Court further held that applying the equitable estoppel doctrine was "in accordance with existing Georgia law."⁵³