

Court ruling on subcontracts casts doubt into nearly every construction project

■ *Now general contractors can't depend on standard incorporation clauses to impose the terms of a general contract onto a subcontractor.*

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The Court of Appeals, in *Edifice Construction Co. v. Arrow Insulation* (unpublished), upended core principles of construction law by slashing an incorporation clause from American Institute of Architects form subcontract. Specifically, the court ignored a clear and unambiguous provision in the subcontract expressly incorporating the entire general contract.

In sum, this decision casts doubt on every subcontract that incorporates a prime contract by reference. It also sounds a clear departure from precedent favoring arbitration and liberally incorporating dispute resolution provisions from general contracts into subcontracts. By doing so, the Court of Appeals has injected uncertainty into nearly every construction project.

Ultimately, this decision opens general contractors to inconsistent outcomes, increased litigation risks and greater costs by allowing subcontractors to avoid the prime contract disputes clause.

For background, Edifice was the general contractor for a residential construction project. The developer organized the project into phases I and II and used separate contracts based on AIA series A102 and A103 forms for each phase (together, the "Main Contracts"). And the Main Contracts mandated binding arbitration between Edifice and the owner.

As is common in the industry, each subcontractor (except one) signed a separate subcontract (the A201) that ran in parallel to the Main Contracts for phases I and II. Also following the industry standard, every subcontract was identical and had two clauses that incorporated the Main Contracts.

Under the first clause, the subcontractors agreed to be bound by "all provisions of the Main Contract." The subcontractors also agreed that the Main Contracts were incorporated by reference and "expressly made part of" the subcontract.

The second provision of the subcontract contained a "pass-through" clause. Under this clause, the subcontractors agreed that in the event of any dispute

between a subcontractor and Edifice the subcontractor would be "bound to contractor to the same extent the contractor is bound to owner by the terms of the Main Contract."

Years later, the owner sent Edifice a notice of intent to arbitrate for alleged construction defects. Edifice, in turn, sent arbitration notices to the subcontractors. Later, Edifice moved to compel arbitration against the subcontractors. The subcontractors resisted arbitration and successfully defeated Edifice's motion in the trial court, which held that the subcontractors had not agreed, despite executing their respective subcontracts, to the dispute resolution provision in the Main Contracts.

After losing in the trial court, Edifice appealed. But Edifice lost again, and the Court of Appeals affirmed the trial court's decision. In particular, the Court of Appeals held that Edifice never showed its subcontractors the Main Contracts. Nor did Edifice show that the AIA forms used as the basis for the Main Contracts were common in the industry. As a result, the Court of Appeals held that the subcontractors never knew of, or accepted, the terms of the Main Contracts.

The result of this case should concern general contractors. To begin with, Edifice now must simultaneously defend against the owner's arbitration claim while also pursuing its rights against the subcontractors in court. And Edifice risks getting different results from the two adjudications.

This is exactly the problem the form AIA documents sought to solve. Yet the Court of Appeal's decision makes the muddled outcome facing Edifice ripe for repetition.

Even more alarming than the specifics of Edifice Construction is the impact the Court of Appeal's decisions may have on similar provisions in many, if not most, subcontract agreements. While the core issue in Edifice was whether the subcontractors could be compelled to arbitrate by the general contractor, the decision calls every subcontract incorporating any prime contract into question. In short, general contractors cannot depend on standard incorporation clauses to

impose the terms of a general contract onto a subcontractor.

Indeed, although the Court of Appeals does not indicate what actions a general contractor must take to effectuate full incorporation, one way to potentially ensure that a subcontract incorporation clause is effective is to hand deliver the general contract to the subcontractor and to include language in the subcontract acknowledging such receipt. At the moment, it is likely that few — if any — general contractors do this.

Finally, the Court of Appeal's decision also exemplifies a sharp break from precedent favoring arbitration. As recently as 2009, for example, courts have held that construction subcontracts that explicitly incorporate arbitration clauses from the general contract can compel subcontractors into arbitration. See *Heights at Issaquah Ridge Owners Association v. Burton Landscape Group* (2009), holding that a subcontract that "incorporated the disputes provision of the general contract, which required that all disputes be arbitrated" showed "that the parties shared a clear intent to submit all disputes relating to the contract to arbitration."

Even more, Washington law "indulge(s) every presumption 'in favor of arbitration.'"

Given this background, Edifice may appeal this decision and ask the Supreme Court to clarify the apparent split in the case law.

Contractors can manage the uncertainty created by this decision by changing their subcontracting procedure and form subcontracts in three ways:

1. Contractors should consider having their subcontractors initial beside the paragraph of the subcontract that incorporates the general contract.

2. Contractors should consider adding a new provision to their subcontracts that provides that the contractor has given the subcontractor a copy of the general contract, the subcontractor has received the general contract, and the subcontractor has read and understands the general contract.

3. Contractors should consider including dispute resolution provisions in their subcontracts that restate the provision from the general contract and include consolidation language, so that all disputes can be heard together.

The Court of Appeals has turned the concept of prime contract incorporation on its head and general contractors need to carefully evaluate the subcontract language they use going forward.

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