

Prompt Payment Law Update

Appellate Court Rules that Expedited Arbitration Overrides Subcontract Litigation Clause

The Appellate Division, Third Department, upheld the provisions of the Prompt Payment Act's ("PPA's") expedited arbitration requirement, even in the face of a construction dispute resolution subcontract clause which required the parties to go to court. In its April 14, 2016 decision, the Appellate Division affirmed the lower court's decision, which refused to grant the contractor's application for a permanent stay of the expedited arbitration mandated by the Prompt Payment Act (PPA).

In this case, the petitioner, a contractor, entered into a construction contract ("the subcontract") with the respondent, a subcontractor. When a dispute arose and the contractor withheld payments from the subcontractor, the subcontractor sought expedited arbitration under General Business Law article 35-E ("the PPA"). The contractor then sought to permanently stay the arbitration on the ground that section 6.2 of the subcontract expressly stated that litigation, not arbitration, is the parties' chosen method of dispute resolution. The lower court denied the contractor's application, interpreting the PPA to render the subcontract's dispute resolution provision void and unenforceable because it denies the subcontractor the option to arbitrate the payment dispute.

The Appellate Division found that "The purpose of expediting payment is effectuated by General Business Law section 756-b(3)(c), which states that if a contractor is accused of violating any of the PPA's provisions, an aggrieved subcontractor 'may refer the matter to the American Arbitration Association for an expedited arbitration.'

The court also notes, "The PPA also states that, '[except as otherwise provided in this article,] the terms and conditions of the parties' written agreement will supersede the PPA's provisions (General Business Law section 756-a). However the General Business Law section 757(3) specifically directs that 'a provision, covenant, clause or understanding in, collateral to or affecting a construction contract stating that expedited arbitration as expressly provided for and in the manner established by General Business Law section 756-b, is unavailable to one or both parties' is 'void and unenforceable.'

The appellate court concluded that, "the obvious function of section 6.2 of the subcontract is to establish litigation as the sole legal option for the resolution of disputes under the subcontract, which, in turn, denies both parties the opportunity to

arbitrate such claims. Inasmuch as the General Business Law section 757(3) clearly operates to void and render unenforceable the subcontract's dispute resolution provision, we find the Supreme Court properly denied the contractor's application to stay arbitration [and we affirm that decision]."

Osborn Law Notes

The Appellate Division decision in **Matter of Capital Siding & Constr., LLC (Alltek Energy Sys., Inc. (2016 NY Slip Op 02878))**, demonstrates that parties entering into a subcontract on a private construction project must give careful consideration to the PPA when preparing and negotiating the subcontract. It is clear that the PPA's expedited arbitration provisions may override otherwise appropriate and enforceable dispute resolution clauses. Although effective in protecting subcontractors, in many instances, the PPA's impact—by requiring arbitration—can be disruptive to the contractor's financial project management, and, in many instances, may not be in sync with the contractor's process for deciding payment disputes with the owner, which often requires adjudication in court. Before signing a subcontract or proceeding with litigation, careful analysis of the PPA is essential, as there are instances in which the PPA will not apply. At the same time, there may be a question as to whether the mandatory expedited arbitration is constitutional.

Our Practice

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For media inquiries, please contact Alanna Rohan at arohan@osbornlaw.com.