CONSTRUCTION DEFECT LITIGATION

KEY CONTRACT CONSIDERATIONS FOR THE TRANSACTIONAL ATTORNEY

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YOUR CLIENT HAS BEEN SUED FOR CONSTRUCTION DEFECTS

› Your client is the Owner or the Developer
› Your client is a single Owner/Developer in a chain of owners
› You participated in drafting the Purchase Agreement or reviewing Construction Contract
  ➢ Focus three years ago: getting the deal done
  ➢ Focus today: who is paying for the claim and can they pay

CRITICAL PROVISIONS FOR THE CONSTRUCTION DEFECT LITIGATOR

› Indemnification and defense
› Insurance
› Choice of Venue
› Alternative Dispute Resolution
CONTROLING DOCUMENTS

- Purchase Agreement and Escrow Instructions
- General Contracting Agreement
- AIA Agreements
- Insurance Policies
- Insurance Endorsements (or Certificates)
- Wrap Enrollment Roster
- All contracts, from the Master Developer to Subcontractors

INDEMNIFICATION

Who       What       When       How

WHO

Developer: Defends and indemnifies the Seller of the Property. May defend and indemnify a Master Developer or Owner.

General Contractor: Defends and indemnifies the Developer or the Owner.
WHO IS INDEMNIFIED

"The Owner, the parent companies and affiliates of the above-mentioned parties, and the directors, officers, shareholders, partners, employees, representatives and agents of any of the above-mentioned parties..."

DON'T FORGET TO INCLUDE YOUR JOINT VENTURE PARTNERS AND LIMITED LIABILITY MEMBERS

WHEN

- When does indemnitor start defending? Immediately? Pay for defense only after a judgment?
- Is it based on a finding of fault on the part of the indemnitee? Does indemnitee pay a judgment or settlement? Or is it reimbursed afterwards?
- Is the indemnitee solvent?
- Who controls the money?
  - Letter of credit – renewals
  - Escrow account for the duration of the statute of repose/limitations. Access to funds.
Proportional Reimbursement of Defense Costs

"Contractor shall not be obligated to defend or indemnify any Indemnified Party for that portion of the Claims ultimately determined by final judgment to arise out of the negligence or willful misconduct of that Indemnified Party. Further, the Indemnified Parties shall reimburse Contractor for any costs, including without limitation attorney’s fees and expert witness fees incurred to defend against any Claims or the portion of any Claims ultimately determined by final judgment to arise out of the negligence or willful misconduct of the indemnified parties."

INDEMNIFIED FOR WHAT?

"...from and against any and all losses, costs, expenses, damages, injuries, liabilities, claims, demands, penalties or causes of action, including, without limitation, attorneys' fees (collectively, "Claims"), and including Claims ... and damage to property, arising out of or resulting from the performance of the Work under this Contract, but only for that portion of the Claims caused by the negligent acts or omissions of the Contractor, its Subcontractors, Sub-Contractors, suppliers, or anyone directly or indirectly employed by any of them, or anyone for whose acts they may be liable."

"WHAT" CONTINUED

› Arising from the work
› Development of condominiums
› Fulfillment of government entitlements
› Development of raw land
› Zoning
› Any soil or grading conditions
› As-is conditions of property sold
HOW: RULES OF ENGAGEMENT

- Procedures to specify:
  - Notice
  - Time for accepting defense
  - Joint or separate defense
  - Method of payment for defense and damages
  - Earmarked funds for defense and damages
  - Collateral
  - Release terms
  - Penalty for failure to honor procedures

DEFENSE

- Is there a separate duty to defend, even if there is no basis for indemnification?
  - Separate provision
- Is there a right to select counsel?
  - Approval of counsel shall not be "unreasonably withheld"
- Joint defense counsel
- Separate counsel
  - Potential conflicts between the Indemnitor and Indemnitee

INSURANCE

- Commercial General Liability Coverage
- Professional Liability Coverage
- Products/Completed Operations for statute of repose/limitation periods
- Occurrence (damage in policy period)
  - Claims Made – don't create a gap
- Solvency of Insurance Carrier
- Project specific
Practice Pitfalls: The $2m Typo

Broad Form Comprehensive or Commercial General Liability Insurance ("CGL") written on an occurrence basis (including Premises/Operations Liability, Products and Completed Operations Liability, Independent Contractors Liability, Contractual Liability, Broad Form Property Damage Liability, Explosion, Collapse and Underground Hazard Liability and Personal Injury Liability) (CGL) in the minimum amount of Three Million Dollars ($1,000,000) per occurrence combined single limit for bodily injury and property damage and in the minimum amount of Two Million Dollars ($2,000,000) total aggregate liability.

Who Cares, Changed Horses

- The $2 million typo may not matter
- Switched to a wrap policy
- Potential problem: expectation of GC policy in excess to a wrap
- Clean up the contracts with a formal Addendum, because the construction defect lawyer will be tendering to all available policies

Self-Insured Retention

- Who must pay
  - Many policies require that the named insured pay
- First Dollar Defense
  - Best for Indemnitee
- Large SIR
  - How is it funded
  - Guarding against insolvency
Construction Defect Litigation and ADR for the Transactional Attorney

An SIR Cautionary Tale

- Multi-unit apartment complex to condominium conversion
- Owner, General Contractor and Subcontractors in Wrap
  - Wrap cost: $800k
  - $1 Million SIR
- Who pays the SIR
  - Who is solvent?
  - Will subcontractor contribution satisfy the SIR?

Get the Endorsement:
Bad example

- Prior to execution of this Subcontract, the Subcontractor shall deliver to the Contractor Certificates of Insurance, certifying the types and amounts of coverage, certifying that said insurance will be in force before Subcontractor starts work, and certifying that said insurance applies to all activities and liability of the Subcontractor pursuant to this Subcontract..., and the Subcontractor shall obtain an endorsement to its policies and insurance certificates providing substantially as follows:

Additional Insured Endorsement

- Contract requires that the policy for the AI have same terms, but does the endorsement limit coverage?
- Completed operations vs. ongoing
- Primary vs. excess, non-contributing
- Correct name of the certificate holder
- Review policy and endorsement each year for changes

Wrap Policy Provision: Owner Assumes Control

"The Owner has elected to purchase an insurance policy naming it as well as other designated Construction Participants, including Contractor, for certain risks associated with the Work. Contractor is not charged with the responsibility of reviewing and obtaining counsel regarding this insurance policy and Owner expressly acknowledges that the Contractor may rely upon any representations and samples of policy language or policies made or furnished by Owner or its representatives regarding the nature and quality of the insurance provided by the Wrap Up policy."

Wrap Policy Provision: Owner Disclaims Adequacy

"Owner has elected to procure insurance in limits set forth in the Insurance Manual (Exhibit Z). Owner makes no representations to Contractor that the limits are adequate for insurance coverage on the Owner's project. Contractor may, at its sole discretion, decide to procure additional insurance limits for off-site work or liabilities not covered by the Wrap Up or as Difference in Conditions and excess insurance to the limits provided by the Wrap Up policy."

Is the limit of the wrap adequate?

- Now there is one policy where there used to be many.
- Contractual indemnity provisions can create rights to seek uncovered damages, excess damages, SIR contributions, etc. which remain intact despite the wrap policy.
CHOICE OF VENUE

- Locus of the property
- Pitfalls:
  - Not understanding the statutory climate in order to adjust other protections
  - Warranties created by statute
  - Are there defects defined by statute in the absence of property damage?
  - What does case law say about payment of SIR?
  - Limits to the type of indemnification that can be sought, i.e., if Indemnitee is partially or wholly at fault

ALTERNATIVE DISPUTE RESOLUTION

- For all claims
- Only for certain claims
- Not required for an indemnification or third-party claim

THE END

Presented by:
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CRITICAL PROVISIONS FOR INDEMNIFICATION AND INSURANCE

Indemnity Agreement Samples

1. **Between developers of apartments/condominiums**

   Release and Indemnity. Indemnitor hereby releases Indemnitee from, and hereby indemnifies, defends and agrees to hold Indemnitee harmless from and against, any and all costs, losses, damages, claims, liabilities and expenses [including attorneys, expert fees, and enforcement expenses] which Indemnitee may suffer, incur and/or becomes liable or obligated which results from and/or arises out of any claims by unit purchasers or the condominium association or their successors and/or assigns with respect to (a) the physical condition of the Property or any portion thereof, (b) the conversion of the Property or any portion thereof to condominiums and the marketing and sale of condominium units, and/or (c) any claims relating to the compliance of the conversion, sale and marketing of the Property with applicable laws. [The provision goes on to specify indemnification for any sort of claim, including property damage arising from construction and design defect and breaches of warranties arising from the original construction and the conversion.]

2. **Engineer/Design Professional to Owner**

   Consultant shall, to the fullest extent permitted by law, with respect to all work and professional services rendered by Consultant pursuant to this Agreement, indemnify and hold Client/Owner and any of its partners, lenders, officers, agents, employees, and affiliated (defined as common ownership) entities (collectively referred to as "Indemnitees") harmless from and against any claim, liability, loss, damage, costs, expense, and attorneys' fees, awards, fines, or judgments by reason of the death or bodily injury to persons, injury to property, design defects (if the design was...)

3. **Subcontractor to General Contractor and Owner**

   The TRADE CONTRACTOR shall, with respect to all such work which is covered by or incidental to this TRADE CONTRACT AGREEMENT, defend (with counsel reasonably acceptable to the CONTRACTOR), indemnify and hold the CONTRACTOR and the OWNER harmless from and against each all of the following:

   1. Any claim, liability, loss, damage, costs, expenses, including attorneys' fees and the Contractor's costs of enforcing this indemnity, awards, fines or judgments arising by reason of the death or bodily injury to persons, injury to property, design defects (if the design was...
originated by the Trade Contractor, his supplier, employee or agent), or other loss, damage or expense, including any of the same resulting from Contractor’s or Owner’s alleged or actual negligent act or omission regardless of whether such act or omission is active or passive; provided, however, the Trade Contractor shall not be obligated under this Trade Contract Agreement to indemnify the Contractor or the Owner with respect to damages which are due to the sole negligence or willful misconduct of the contractor and/or the owner, their agents or servants.

4. **Subcontractor to Contractor and Owner**

The Subcontractor covenants to defend, indemnify, save harmless, protect, and exonerate both the Contractor (its agents, employees, representatives, and sureties) and the Owner from any and all liability, claims, losses, suits, actions, demands, arbitrations, administrative proceedings, awards, judgments, expenses, attorneys’ fees and costs pertaining to economic loss or damages, labor disputes, nonperformance of obligations, personal injury, death, or property damage which arise from or are connected with any other act or omission relating to the Subcontractor or to this Subcontract. The foregoing covenants and indemnity obligations shall apply to the fullest extent permitted by law, excepting only liability which is imposed exclusively because of the sole negligence or willful misconduct of Contractor, its agents or servants or subcontractors who are directly responsible to Contractor, excluding Subcontractor herein. The Subcontractor’s liability insurance policies shall each contain contractual insurance coverage (including but not limited to products liability and completed operations) so as to protect fully the Subcontractor, Contractor, and Owner.

5. **Specific Procedures in case of indemnity demand**

The following provisions govern actions for indemnity under this Agreement. Promptly after receipt by an indemnitee of notice of any claim, such indemnitee will, if a claim in respect thereof is to be made against the indemnitor, deliver to the indemnitor written notice thereof and the indemnitor shall have the right to participate in such proceeding and, if the indemnitor agrees in writing that it will be responsible for any costs, expenses, judgments, damages, and losses incurred by the indemnitee with respect to such claim, to assume the defense thereof, with counsel mutually satisfactory to the parties; provided, however, that an indemnitee shall have the right to retain its own counsel, with the fees and expenses to be paid by the indemnitor, if the indemnitee reasonably believes that representation of such indemnitee by the counsel retained by the indemnitor would be inappropriate due to actual or potential differing interests between such indemnitee and any other party represented by such counsel in such proceeding. The failure of indemnitee to deliver written notice to the indemnitor within a reasonable time after indemnitee receives notice of any such claim shall relieve such indemnitor of any liability to the indemnitee under this indemnity only if and to the extent that such failure is prejudicial to its ability to defend such action, and the omission so to deliver written notice to the indemnitor will not relieve it of any other liability that it may have to any indemnitee. If an indemnitee settles a claim without the prior written consent of the indemnitor, then the indemnitor shall be released
from liability with respect to such claim unless the indemnitor has unreasonably withheld such consent.

6. **Indemnity with Procedures**

**Release and Indemnity.** Indemnitor hereby releases Indemnitee from, and hereby indemnifies, defends and agrees to hold Indemnitee harmless from and against, any and all costs, losses, damages, claims, liabilities and expenses (including without limitation reasonable attorney’s fees, expert witness fees, and other third party expenses, including, without limitation, any fees, costs or expenses incurred in connection with enforcing this Agreement) which Indemnitee may suffer, incur and/or becomes liable or obligated which results from and/or arises out of any claims by unit purchasers or the condominium association or their successors and/or assigns (a “Claimant”) with respect to (a) the physical condition of the Property or any portion thereof, (b) the conversion of the Property or any portion thereof to condominiums and the marketing and sale of condominium units, and/or (c) any claims relating to the compliance of the conversion, sale and marketing of the Property with applicable laws. Without limiting the generality of the foregoing, the release and indemnity provided hereby shall encompass any and all claims (whether alleging negligence, fraud, misrepresentation, liability in tort, or otherwise) that may hereafter be made by a Claimant alleging damage, including without limitation property damage or bodily injury, arising out of or related to construction defects, design defects, breach of express or implied warranties, or relating to the physical condition of the Property, regardless whether any real or alleged defects relate to or arise out of the original construction of the Improvements, the condition of the Property as of the sale of the Property from Indemnitee to Indemnitor, the conversion of the Property to condominiums, or otherwise.

7. **Indemnification Procedures**

A claim by Indemnitee for indemnification under Section X of this Agreement (an “Indemnification Claim”) shall be made by Indemnitee by delivery of a written notice to Indemnitor request indemnification.

(a) If Indemnitor is responsible under Section X hereof for such Indemnification Claim, then Indemnitor shall promptly undertake the defense of Indemnitee by appropriate proceedings, utilizing counsel approved in writing by Indemnitee, which proceedings shall be settled or prosecuted by Indemnitor to a final conclusion. Indemnitor shall keep Indemnitee fully advised with respect to all proceedings relating to Indemnification Claims. If Indemnitee desires to actively participate in the defense or settlement of any Indemnification Claim, it may do so at its own cost and expense; provided, however, that if Indemnitor and/or its counsel is not diligently prosecuting such defense and/or proceedings, in Indemnitee’s reasonable discretion, Indemnitee may participate in the defense or settlement and hire separate counsel, at Indemnitor’s cost and expense.
If a claim made by Indemnitee hereunder is an Indemnified Claim covered under Section X of this Agreement and Indemnitor fails to promptly defend such claim, Indemnitee may proceed to defend itself against such Indemnification Claim and all costs incurred by Indemnitee shall be added to Indemnitee's claim for indemnification and paid by Indemnitor.

Any settlement of a third party claim shall include an unconditional release of Indemnitee from all liability in respect of such claim.

8. Collateral or Letter of Credit for Indemnification and Defense Costs

The Indemnification Agreement shall be unlimited in amount, but shall be secured by Collateral (as defined herein) in an amount (the "Required Amount") equal to $X,000,000.00 (if the premium for the Pro Forma Policy is paid at or before closing or $Y,000,000.00 if the premium for the Pro Forma Policy is paid after Closing) from the Closing Date through the tenth anniversary of the Closing Date. The Collateral may be provided in one of two ways, as follows:

(a) First, Purchaser may provide Seller with cash collateral in the Required Amount. The terms governing such cash collateral shall be set forth in the Indemnification Agreement (and are contained in Exhibit H attached hereto). If Purchaser elects to proceed under this Section (a), Seller, Purchaser and the bank in which the cash collateral will be held (which shall be selected by Purchaser but must be acceptable to Seller) shall enter into a Bank Account Agreement, Assignment and Security Agreement, and the term “Collateral” as used herein shall mean the Bank Account Agreement, together with the deposit of cash in the Required Amount into the account established in connection with the Bank Account Agreement.

(b) Second, Purchaser may provide Seller with a clean, irrevocable letter of credit in the Required Amount, issued by a bank acceptable to Seller (the "Letter of Credit"). The Letter of Credit must have a so-called "evergreen" clause, providing that it will automatically be renewed on an annual basis, must provide that Seller may make a draw thereunder by delivering to the issuing bank a statement certifying that Seller is entitled to make a draw under the Letter of Credit pursuant to the terms of the Indemnification Agreement (and subject to no other conditions), and must otherwise be acceptable to Seller in its sole discretion. If Purchaser elects to proceed under this Section, the term “Collateral” as used herein shall mean the original Letter of Credit.

If Purchaser elects to provide Collateral pursuant to Sections (b) above, Purchaser may at any time thereafter replace such Collateral with cash collateral in accordance with Section(a). In such event, Purchaser shall execute and deliver to Seller a revised Indemnification Agreement, containing the provisions required by Section (a) Purchaser shall execute and deliver to Seller a Bank Account Agreement, signed by Purchaser and a bank reasonably acceptable to Seller, and Purchaser shall deposit cash in the Required Amount with such bank pursuant to the Bank Account Agreement, whereupon Seller shall return the Letter of Credit to Purchaser or release the Mortgage, as applicable.
9. **Indemnity with explanation of comparative fault reimbursement of defense costs**

To the fullest extent permitted by law, the Contractor shall indemnify, defend, protect and hold harmless the Owner, the parent companies and affiliates of the above-mentioned parties, and the directors, officers, shareholders, partners, employees, representatives and agents of any of the above-mentioned parties (the “**Indemnified Party**” or “**Indemnified Parties**”) from and against any and all losses, costs, expenses, damages, injuries, liabilities, claims, demands, penalties or causes of action, including, without limitation, attorneys’ fees (collectively, “**Claims**”), and including Claims arising from injuries or death of persons (Contractor’s employees included) and damage to property, arising out of or resulting from the performance of the Work under this Contract, but only for that portion of the Claims caused by the negligent acts or omissions of the Contractor, its Subcontractors, Sub-Contractors, suppliers, or anyone directly or indirectly employed by any of them, or anyone for whose acts they may be liable. Contractor shall not be obligated to defend or indemnify any Indemnified Party for that portion of the Claims ultimately determined by final judgment to arise out of the negligence or willful misconduct of that Indemnified Party. Further, the Indemnified Parties shall reimburse Contractor for any costs, including without limitation attorney’s fees and expert witness fees (“**Defense Costs**”) incurred to defend against any Claims or the portion of any Claims ultimately determined by final judgment to arise out of the negligence or willful misconduct of the Indemnified parties. In the event the Claims are dismissed, settled, released, discharged or otherwise resolved before the entry of final judgment, then the amount of Defense Costs to be reimbursed to Contractor shall be that percentage of the total Defense Costs that bears the same ratio as the amount paid by the Indemnified Parties to settle the Claims bears to the total dollar amount of the settlement. By way of example only, if the Indemnified Parties pay forty percent (40%) of the total amount paid to settle the Claims, then the indemnified Parties shall reimburse Contractor forty percent (40%) of the total Defense Costs incurred by Contractor to defend the Indemnified parties from the Claims, even if the Claims do not proceed to final judgment.

The Contractor shall promptly advise the Owner in writing of any action, administrative or legal proceeding or investigation as to which this indemnification applies, and the Contractor, at Contractor’s expense, shall at Owner’s request assume on behalf of the Owner and conduct with due diligence and in good faith the defense thereof with counsel satisfactory to Owner; provided, that Owner shall have the right to be represented therein by advisory counsel of its own selection and at its own expense. In the event of failure by Contractor to fully perform in accordance with this Indemnification Section, Owner, at its option, and without relieving Contractor of its obligations hereunder, may so perform, but all costs and expenses so incurred by Owner in that event shall be reimbursed by Contractor to Owner, together with interest on the same from the date any such expense was paid by Owner until reimbursed by Contractor, at the rate of interest provided to be paid on judgments by the law of California. The obligations of Contractor under this section shall survive the expiration of the Contract.
Sample Insurance Provisions

1. **Subcontractor to Contractor and Owner**

The Subcontractor shall obtain, before commencement of work, and maintain until final acceptance of the Prime Contract, full insurance coverage, including as a minimum the same types of insurance as the same policy limits which are specified by the Prime Contract or which the Contractor actually obtains for this Project, whichever area greater. The Subcontractor is hereby made responsible for determining the types and extent of such additional insurance as may be necessary to give adequate and complete protection to the Subcontractor, the Contractor, and the Owner from claims for property damage and from claims for personal injury, including death, which may arise from or be connected with this Subcontract, whether such claims relate to acts of omissions of Subcontractor, of any of its subcontractors, or anyone directly or indirectly employed by any of them. If the Contractor or the Owner carries builder’s risk or other insurance which may apply to the Subcontractor’s work or which otherwise may inure to the benefit of the Subcontractor, the Subcontractor shall be responsible for all deductibles and for any inadequacy or absence of coverage, and the Subcontractor shall have no claim or other recourse against the Contractor or against the Owner for any costs or loss attributable to such deductibles or coverage limitations. The Commercial Liability Insurance shall be on an occurrence basis only.

Prior to execution of this Subcontract, the Subcontractor shall deliver to the Contractor Certificates of Insurance, certifying the types and amounts of coverage, certifying that said insurance will be in force before Subcontractor starts work, and certifying that said insurance applies to all activities and liability of the Subcontractor pursuant to this Subcontract. No policy of insurance may be canceled or reduced during the period of construction, and the Subcontractor shall obtain an endorsement to its policies and insurance certificates providing substantially as follows:

- Insurer may not cancel this policy or reduce coverage for a period of thirty (30) days after Contractor has acknowledged receipt of written notice of the Insurer’s intention to cancel or reduce the coverage.

- The Contractor and Owner shall be named as additional insured as respect to work performed by Subcontractor. Insurance afforded the additional insured shall be primary insurance and any other insurance carried by the Contractor will be excess and non-contributory with Subcontractor’s insurance.

The insurance and indemnity obligations of this Subcontract are non-delegable. The Subcontractor shall not sublet nor subcontract any part of this Subcontract without retaining absolute responsibility for requiring similar Insurance from its subcontractors and suppliers. The Subcontractor’s failure to maintain complete insurance shall be a breach authorizing the Contractor, at the Contractor’s sole election, either to terminate this Subcontract or to provide full insurance coverage at the Subcontractor’s sole expense; however, in neither case shall the Subcontractor’s liability be lessened.
2. **General Contractor to Owner**

As part of the Contractor’s obligations and responsibilities under Paragraph X, and for the Contractor’s protection and benefit, and for the protection and benefit of the Owner and any and all of its partners, officers, directors, shareholders, beneficiaries, agents and employees including, but not limited to, the entities listed in Subparagraph Y (collectively the "Indemnitees"), which Indemnitees shall be named as an additional insured, the Contractor shall procure, pay for and maintain, in full force and effect until the Work is completed (unless otherwise designated), at no expense to the Owner, the following policies of insurance to be written by an insurer with a Best’s rating of no less than A++XV with respect to general liability, who is authorized to do business in the State in which the Project is located and which shall, as a minimum, afford the following types and limits of coverage:

1. **Broad Form Comprehensive or Commercial General Liability Insurance ("CGL")** written on an occurrence basis (including Premises/Operations Liability, Products and Completed Operations Liability, Independent Contractors Liability, Contractual Liability, Broad Form Property Damage Liability, Explosion, Collapse and Underground Hazard Liability and Personal Injury Liability) (CGL) in the minimum amount of One Million Dollars ($1,000,000) per occurrence combined single limit for bodily injury and property damage and in the minimum amount of Two Million Dollars ($2,000,000) total aggregate liability;

2. **Worker’s Compensation Insurance** in the amount not less than the limits required by law with Employer’s Liability Insurance in a minimum amount of One Million Dollars ($1,000,000);

3. **Such other insurance as the Owner may reasonably require.**

If the Contractor fails to purchase and maintain any insurance required under this Article 22, the Owner may, but shall not be obligated to, upon five (5) days’ written notice to the Contractor, purchase such insurance on behalf of the Contractor and shall be entitled to be reimbursed by the Contractor promptly upon demand or deduct the amount of such premiums from the Contract Sum.

3. **Simple CGL Insurance**

Comprehensive Liability in the amount of $1,000,000 combined single limit of bodily injury and/or property damage liability including the following:

a. Manufacturers and Contractors basic coverage with X, C and U exclusions deleted;

b. Completed operations coverage;

c. Contractors protective coverage;

d. Auto, hired car, and auto non-ownership coverage;

e. Full Blanket Contractual coverage;
f. An endorsement affording 30 days notice to CONTRACTOR in event of cancellation or reduction in coverage.
g. An endorsement providing that such insurance, as is afforded under SUBCONTRACTOR’S policy, is primary insurance as respects the CONTRACTOR and that non-contribution with the insurance required thereunder.
h. Subcontract work, if any portion of this work is subcontracted by the SUBCONTRACTOR.
i. “All Operations” will not be accepted. You must have job description on certificate.

All such insurance shall be in a form satisfactory to the CONTRACTOR and underwritten by insurance companies satisfactory to the CONTRACTOR, before the SUBCONTRACTOR performs any work at, or prepares or delivers materials to the site of construction. SUBCONTRACTOR shall furnish Certificates of Insurance evidencing the foregoing insurance coverage and such certificates shall provide that the insurance is in force and will not be cancelled without thirty (30) days written notice to the CONTRACTOR. SUBCONTRACTOR shall maintain all of the foregoing insurance coverage in force until the work under this SUBCONTRACT AGREEMENT is fully completed; except as to liability coverage for Products/Completed Operations, which are to be maintained for ten (10) years following completion of the work and acceptance by the CONTRACTOR. The requirement for carrying the insurance set forth in this section shall not derogate in any way from the provisions for the indemnification of the CONTRACTOR by the SUBCONTRACTOR set forth herein. If the SUBCONTRACTOR fails to secure and maintain the required insurance, the CONTRACTOR shall have the rights (without obligation to do so, however) to secure same in the name of and for the account of the SUBCONTRACTOR, in the event the SUBCONTRACTOR shall pay the cost thereof and shall furnish upon demand all information that may be required therewith.

No payment will be made until the executed proper endorsements have been received in our office from SUBCONTRACTOR.

Sample Indemnity and Insurance in Wrap

1. **AIA A201 with Wrap Language**

**INDEMNIFICATION**

To the fullest extent permitted by law and to the extent claims, damages, losses or expenses are not covered by Project Management Protective Liability insurance purchased by the Contractor in accordance with Paragraph X, the Contractor shall indemnify and hold harmless the Owner, Architect, Architect’s consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including but not limited to attorneys’ fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by the negligent acts or omissions of the Contractor, a Subcontractor, any directly or indirectly employed by them or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder. Such obligation shall not be
construed to negate, abridge, or reduce other rights or obligations of indemnity which would otherwise exist as to a party or person described in this Paragraph.

---Notwithstanding the provisions of Sections X and Y above to the extent that insurance is available under the Wrap Up insurance policy (described in Section Z) to protect Owner and each of the indemnitees, and only to that extent that the insurance procured thereunder does in fact fully protect Owner and the other indemnitees, that obligations of Contractor under this Section X are limited to any such insurance and do not take effect even if the insurance provided under the Wrap Up is exhausted or otherwise unavailable.

2. Wrap with Subcontractor Premiums

CONTRACTOR’S LIABILITY INSURANCE
The Contractor shall purchase from and maintain in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located such insurance as will protect the Contractor from claims set forth below which may arise out of or result from the Contractor’s operations under the Contract and for which the Contractor may be legally liable, whether such operations be by the Contractor or by a Subcontractor or by any directly or indirectly employed by any of them, or by anyone for whose acts any of them may be liable. The Owner has elected to purchase an Insurance policy naming it as well as other designated Construction Participants, including Contractor, for certain risks associated with the Work. This policy is known as a Wrap Up policy. The types of risks covered by this policy are listed completely in the Exhibit “Y”.
Contractor is not charged with the responsibility of reviewing and obtaining counsel regarding this insurance policy and Owner expressly acknowledges that the Contractor may rely upon any representations and samples of policy language or policies made or furnished by Owner or its representatives regarding the nature and quality of the insurance provided by the Wrap Up policy. The Wrap Up Insurance policy is intended to be the primary source of coverage for the risks covered and takes the place of Contractor’s primary insurance.

Contractor’s subcontractors shall contribute Insurance premiums to pay towards the premium for the Wrap Up policy. Such contributions from Subcontractors shall be made to Owner through deductions from the amounts otherwise due Subcontractors. Coverage provided under the Wrap Up Insurance policy is set forth in the Insurance policy in full. Without modifying any of the terms and conditions of the policy, the coverage is generally described as Commercial General Liability in the limits described in the declarations page of the policy. The policy is intended to cover third party liability claims arising out of personal injury, advertising injury and property damage claims emanating from the Project.

Coverage is not provided in the following areas and Contractor shall purchase from an Insurance carrier reasonably acceptable to Owner, and maintain such Insurance as will protect the Contractor from claims set forth below which may arise out of or result from the Contractor’s operations under the Contract and for which the Contractor may be legally liable, whether such operations be by the Contractor or by a Subcontractor or by anyone directly or indirectly employed by any of them, or by anyone for whose acts any of them may be liable: [automobile, worker’s compensation, etc.]
3. **Wrap with Subcontractors**

Contractor shall be subject to the provisions of the Owner’s program as set forth in Exhibit Z. Contractor shall not procure in its own General Liability Insurance for this project unless it elects to secure Difference in Conditions and excess Insurance over the Insurance provided in the Wrap Up. For all activities conducted by Contractor for Owner off the site, Contractor shall maintain Commercial General Liability Insurance on an occurrence basis with a combined single limit for bodily injury and property damage of at least One Million Dollars ($1,000,000) covering Operations, Independent Contractors, Products and Completed Operations (for 10 years after Final Acceptance), contractual liability covering the Indemnification contained in Paragraph [X] of the Agreement, Broad Form Property Damage including completed operations, severability of Interest and Cross Liability clauses, Personal Injury and Explosion, and Collapse and Underground Hazards (X, C, U). The limits of liability may be provided by any combination of primary and excess liability insurance policies.

**Duties to Enroll Subcontractors.** Contractor is cognizant of the provisions of Exhibit Z which require enrollment of sub tiered contractors into the Wrap Up. Contractor shall cooperate with Owner to enroll all Subcontractors into the Wrap Up program.

**Adequacy of Insurance Limits.** Owner has elected to procure Insurance in limits set forth in the Insurance Manual (Exhibit Z). Owner makes no representations to Contractor that the limits are adequate for Insurance coverage on the Owner’s project. Contractor may, at its sole discretion, decide to procure additional Insurance limits for off-site work or liabilities not covered by the Wrap Up or as Difference in Conditions and excess Insurance to the limits provided by the Wrap Up policy. Owner shall cause Wrap Up Insurance to have adequate provisions to make Contractor’s Insurance excess and non contributory to any and all Insurance policies provided by Owner. Owner shall ensure that all subsequent insurance policies purchased by Owner for this purpose contain similar provisions and that proof of such insurance be provided to Contractor even after the project is completed and all funds due are paid to Contractor.

END
Construction Defect Litigation and ADR for the Transactional Attorney

Paul Primavera
Lockton Companies

Current Insurance Market Conditions

Soft Market
Underwriter’s Intent vs. Claim Interpretation
Rising Losses
Incongruent Coverage Grants

Potential Insurance Policies Responding to a Construction Defect Loss

- Professional Liability
  - Project-Specific

- General Liability
  - Project-Specific
  - Umbrella
  - Combined

- Property
  - Subrogation
  - Incidental Damage
Property Related Coverage – Key Issues

- Length of Coverage
- Potential Applicable Exclusions:
  - Faulty Work
  - Mechanical Breakdown
  - Hidden or Latent Defects
- Sub-limits
- Primacy of Coverage

General Liability Coverage – Key Issues

Coverage Grants
- Occurrence
- Property Damage
- Operational Coverage
- Products-Completed Operations

Potential Exclusions
- Property Damage From Your Work
- Property Damage From Your Product
- Property Damage From Your Faulty Work
- Impaired Property
- Expected or Intended
- Mold, EFIS, Residential
**Coverage Overview**

- Negligent acts, errors, and omissions performing professional liability services.
- Claims Made Triggers
  - Demands for Money or Services

**Potential Exclusions**

- Property Damage resulting from construction means or methods.
- Insured vs. Insured Claims
- Express warranties or guarantees.
- Product manufactured or supplied by insured.

**Questions**
ALTERNATE DISPUTE RESOLUTION FOR THE
TRANSACTIONAL ATTORNEY
ADR for Construction Defect Disputes

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DRAFTING FOR EFFECTIVE CONFLICT RESOLUTION FOR CONSTRUCTION DEFECT DISPUTES

A. IN GENERAL

1. Even though arbitration is a less formal process than a court hearing, avoid referring to the arbitrator(s) by their first names, even if you know them well. Such informality detracts from the dignity of the arbitration process. Furthermore, it could give rise to a claim of bias as a basis for an appeal of an award, citing the "personal" relationship evidenced by use of first names.

2. Always remember the differences in ADR methods, since each requires a different approach.

   a. Mediation is business based, with the parties in control, and non binding and NON ADVERSARIAL.

   b. Arbitration is rights based, with reliance on theories and claims and counterclaims, right versus wrong, binding and non appealable (except under limited circumstances) and ADVERSARIAL.

3. Beware of the arrogance of assuming an arbitration hearing requires little preparation or familiarity with the rules, having heard that it is only a story being told without rules of evidence. There are various sets of rules promulgated by the American Arbitration Association relating to disputes covering commercial matters, such as construction, securities, real estate valuation and labor. Copies of these rules are available from the AAA offices, and you should always familiarize yourself with the most current set of rules.

4. Do not assume that no matter what is presented in an arbitration hearing, the arbitrators will always award something to everyone, i.e., the Solomon decision. A Special Study prepared by the American Arbitration Association concluded that arbitrators decide clearly in favor of one party over the over in the majority of cases. It found that in 21% of the claims, the claim was denied totally; in 33% of the claims, the arbitrators awarded between 80 and 100% of the claim; in 9% of the claims, the award was less than 20% of the claim; in 12% of the claims, the award was less than 20% and the "Solomon" decision of 40 to 50% of claim was reached in only 12% of the claims.

5. One of the major advantages of arbitration is that you will obtain your results a lot faster than by using the court system. The same American Arbitration Association study shows that the median number of days between filing and award was only 166 days. In those cases of more than $1,000,000, the median number of days was 498 days; and $15,000 or less, only 100 days.
6. Do not be insulted, but the transactional attorney whose last experience was in Moot Court, should not look to arbitration as good "trial" experience in order to get a taste of the "litigation" process. Do not think for a moment that arbitration does not require good court skills such as cross examination ability; it is still no place for the transactional lawyer who wants a shot at the court room experience.

B. THE ARBITRATION CLAUSE

1. The arbitration clause must be carefully prepared by the transactional lawyer and the litigation lawyer in cooperation with each other and should tailored for the particular type of dispute which is the subject of the contract. Even if the AAA has no established rules for your "unique" dispute, do not be constrained to use the process - you can establish your own rules of procedure.

The ability to tailor make a dispute resolution procedure for your particular transaction, and even select the specific panelists based upon expertise agreement at a time where conflict is absent cannot be underestimated.

2. A good arbitration clause will:
   a. be self executing and may be initiated by either party.
   b. take into account joinder of all parties necessary to resolve the dispute. You should obtain the commitment of all parties to participate in the arbitration process at the contract stage. Usually it is too late at the dispute stage.
   c. establish standards for the selection of arbitrators with the expertise sought and should provide for a replacement mechanism in the event a panelist resigns or be unable to serve his or her term for reasons beyond their control.
   d. provide for some limited pre-hearing discovery, but should avoid "everything permitted by the Civil Practice Act," of the jurisdiction.
   e. provide for authority to award attorneys fees and costs, as the arbitrators deem to be just and equitable. This would avoid later disputes over who was a prevailing party, and permits the arbitrators to use their judgment as to the extent to which fees may be awarded.
   f. request a written "reasoned" opinion setting forth the basis upon which the Award was made, if the parties desire it.
   g. designate the place of arbitration to avoid forum shopping or local prejudices.
C. SELECTION OF THE ARBITRATOR

1. The absolute key to any successful arbitration is the quality of the panel. Stay away from the prospective panelist whose credentials read as follows: "Real estate closings, estate planning, negligence, worker compensation claims and complex commercial arbitration." Be willing to pay more for a quality panel than the minimum suggested rate - you usually get what you pay for. Quality arbitrators will be more inclined to serve on a panel which will continue over an extended period of time, if there is not too great a financial sacrifice.

2. Avoid party appointed arbitrators unless they are truly neutral. This occurs when I pick one arbitrator and you pick the other arbitrator and our appointees select the third "neutral" arbitrator. In this author's opinion, use of the partisan arbitrator selection process presents an inherent conflict since she is clearly partisan, but bound by oath and the ethical rules of the American Arbitration Association to act without prejudice to either party.

3. Always investigate the potential arbitrators by contacting other counsel who may have had contact with the arbitrator. Never overlook your own firm's experience. Never assume that nomination as an arbitrator is tantamount to qualification.

D. PRE-HEARING CONSIDERATIONS

1. Make sure all exhibits are marked BEFORE the hearing, and that you have sufficient copies for each member of the panel, opposing counsel and the court reporter, if any. Failure to do this in advance telegraphs poor preparation, and if the strategy is to upset the rhythm of witness examination, good arbitrators sense this strategy and you lose points rather than advance your cause.

2. Provide copies of documents to opposing counsel prior to the hearing, and during the document exchange period. This will avoid the embarrassment of having opposing counsel exclaim that this is the first time they've seen the document, and therefore they will need additional time to review it before they can proceed with their cross examination. Arbitrators will usually give counsel additional time to prepare and any tactical advantage obtained is only illusory.

3. For the "secretive" opponent who refuses to fully disclose or exchange documents, remind them of the power of the arbitrator to subpoena documents, and indicate that you will advise the panel that the subpoena was necessary due to a lack of cooperation by the opposing side. Further, that since documents produced pursuant to subpoena will be seen by you for the first time at the hearing, you will require additional time to review the documents which will delay the process. Chances are that counsel will get the message!

4. Counsel should try to agree on joint exhibits in advance and identify them as such; it is frustrating for the panel to shift from the claimant’s set of exhibits to the respondent’s set of exhibits, where each bears a different identification for the same document.
E. THE HEARING PROCESS

1. Do not permit the "informality" of arbitration to minimize the need for properly preparing your witnesses. Credibility of counsel and the witness come into question when the witness stares at a document she does not recall ever seeing before. What you have done is "sandbagged" your own witness by assuming that less preparation of witnesses is appropriate since there is no judge or jury. Witnesses are under oath and subject to cross-examination; failure to prepare the witness properly can result in an adverse decision simply because the witness' credibility prevents the arbitrators from giving the testimony much probative value.

2. Do not insult your opponent and the arbitrators by not being able to commit to hearing dates because "your secretary is in charge of setting your appointments." You would not do this before a judge, and you have essentially indicated your disdain for the process and have insulted the arbitrators who will decide your case.

3. Remind your witnesses to look at the arbitrators, not at you, when responding to direct or cross-examination.

4. Even though the rules of evidence do not apply, you should always lay a proper foundation for the question or document, and be sure to indicate its materiality and relevance in your case. Even though affidavits are a form of hearsay, the rules do permit arbitrators to admit evidence by way of affidavit. However, the absence of the ability to cross examine the affiant may cause the arbitrators to give the affidavit less weight in their decision. Have your affiant available for cross-examination; at the least, you have reduced the witnesses time by half and reduced the panel's boredom factor by at least that amount.

5. Use objections sparingly, as arbitrators may believe that you are preventing them from hearing evidence on the matter. Use objections to "tell" the arbitrators something such as: leading questions may indicate that the witness is not testifying, counsel is testifying, lack of foundation for a document may cause the arbitrator to attach less weight to it; failure of a witness to respond indicates a witness whose credibility should be questioned by the arbitrators,

One of the best objections is "asked and answered." Properly and consistently made, the message to the arbitrators is clear: counsel is engaged in eliciting repetitious testimony which does not shed new light on the issues and causing delay in the proceedings, while adding nothing new.

6. Is a transcript necessary? In a complex case, daily copy may assist in preparing for cross examination. Transcripts are always of assistance when moving to vacate an award, since the transcript may provide grounds for vacating the award. Ordering a transcript for the arbitrators may not be useful, since the arbitrators have heard the testimony, taken notes and may have caucused between themselves from time to time. An arbitrator faced with voluminous exhibits will look to an equally voluminous transcript with distaste.

7. Do not present the same set of facts several different ways in the hopes that repetition will enforce your position. The arbitrator will not choose the one she wants, but will become bored and not pay attention to the critical evidence which is buried in the repetitious presentations.
Furthermore, all this does is present the opportunity to tender additional, unnecessary and repetitive details which presents the other side with the opportunity to engage in overlong and boring cross examination; the result - a panel which loses interest.

8. Start the case with a strong witness and finish with a strong witness, and the middle witnesses will take care of themselves.

Studies have shown that "decision makers" reach a feeling as to who is right and who is wrong at the close of the opening statement, assuming the evidence will support the opening presentations. Therefore, hit them hard or you will spend the rest of the case trying to change their minds.

9. What does the Arbitrator want to see from counsel?
   a. Claims, counterclaims or defenses should be well documented, all documents should be numbered, and a summary sheet should be prepared for use by the arbitrators during their deliberations.
   b. Documents should be factual documents and self authenticating wherever possible, and when introduced, a foundation should be established as to who prepared the document, when it was prepared, by whom it was prepared and finally that it is THE document.
   c. The evidence should be presented in a logical, rational manner consistent with your opening statements. When the arbitrators have a glazed look, it is usually because they are unable to determine where you are headed - so remind them every so often.
   d. Focus on the important issues and facts and avoid overtrying the case by emphasizing and proving every single fact, regardless of its significance. Who really cares what the witness did in high school if it has nothing to do with case in chief?
   e. Cooperation between counsel at all times and a professional demeanor between counsel and the panel is the rule. Rambo is out and civility is in! This does not mean you cannot be tough or hard, but do not equate rudeness and incivility with the former.
   f. Avoid hyper-technical, never-ending objections - arbitrators want to find out the facts and will wonder what you’re trying to keep out. Remember, the panel was selected for its expertise and sophistication, and unlike a jury, they do not have to be protected from "tainted" evidence.
10. What does counsel want from the panel?

a. The members of the panel should be experienced in the industry and in the arbitration process.

b. The panel should establish the ground rules for admission of evidence, witnesses and discovery, and enforce those ground rules fairly and even-handedly.

c. A firm but fair panel that "runs" the hearings, keeps counsel from making it the "arbitration from hell" and establishes an interest by asking questions during the proceedings.
STANLEY P. SKLAR, ESQ.

WORK HISTORY: Executive Director for Arbitration Studies, DePaul University College of Law, Center for Dispute Resolution, 2009-; Partner, Bell, Boyd & Lloyd LLP, 1995-2008; Partner, Schain, Firs & Burney, 1994-95; Partner, Pretzel & Stouffer, Chtd., 1982-94; Partner, Mann, Cogan, Sklar & Lerman, 1970-82; Associate, Fein & Pesmen, 1964-70.

EXPERIENCE: Over 35 years' experience specializing in real estate and construction representing owners, design professionals, lenders, contractors, subcontractors, and title insurance companies handling contract negotiations, construction claims, commercial lease disputes and workouts. Adjunct Professor, Graduate Real Estate Program, John Marshall School of Law teaching Construction Law. Instructor, Oakton Community College, Architectural Technology Program teaching Construction Law. Master Teacher, Illinois Institute for Continuing Legal Education. Attorney, Northbrook Park District (1971-80) and Northbrook Zoning Board of Appeals (Chair, 1973-99).

ALTERNATIVE DISPUTE RESOLUTION EXPERIENCE: Chaired panels concerning claims in excess of $10 million on several Large Complex Case panel matters and sole arbitrator in several Large Complex Cases. Arbitrator and mediator in construction contract disputes, payment disputes, delay claims, and failure claims; design defects; change order disputes; insurance coverage disputes and surety claims; common area maintenance contributions under multiple shopping center leases; international shopping center disputes; underground tunneling project involving trenchless technology; concrete defects in high rise office building; concrete defects in parking deck and garage structures; alkali silica deterioration for commercial pavers in office complex, concrete failures, curtain wall water intrusion, structural steel failures; HUD financed retirement facilities; marine structures including breakwater construction for lake erosion protection; delay claims relating to processing plant; energy supply contract disputes involving coal mines and public utility; supply contracts for coal forced steam generating plant; energy savings performance contracts; circulating fluidized bed steam generators for power plant, floating casinos, hospital and health center retro-fitting and new construction, lease workletter disputes and workouts, demolition and disposal of nuclear waste; claims relating to auto dealership facility construction; multi-party mediations regarding insurance coverage for construction defects; and title insurance coverage disputes. Member of the AAA Large Complex Case Panel for Commercial and Construction Disputes; AAA Construction Arbitration Master Panel; AAA National Commercial/Construction Arbitrator Training Faculty; and instructor for ACE courses on Ethics, Chairing the Arbitration Panel. Arbitrator, Circuit Court of Cook County Mechanics Lien Section. Mediator, Circuit Court of Cook County Court Annexed Mediation. AAA Faculty: AAA Construction Arbitrator II: Advanced Case Management Issues, 2005; Arbitrator Ethics and Disclosure, 2004, 2005; member, AAA National Construction Dispute Resolution Committee; Member, AAA National Construction Dispute Rules Committee.

ALTERNATIVE DISPUTE RESOLUTION TRAINING: ALI ABA Course on Special Masters in Federal Courts, 12/05; ACE004 - Practical Tips for Dealing with Delay Tactics of Parties and Advocates, Chicago, 4/05; AAA International Arbitration Symposium, San Francisco, 9/03; Attended AAA Neutrals Conference and satisfied 2003 ACE requirements, Providence, 8/03; faculty, AAA Neutrals Conference, Scottsdale, 1/03; AAA Arbitrator Update 2001; AAA Construction Train the Trainer Course, Phoenix, 12/00; attended AAA Mediator Conference Workshop, Chicago, 9/00; AAA Continuing Education, "Concrete Deterioration," Chicago, 9/00; AAA Continuing Education, "Sticks and Stones and Managing the Process of Arbitration," Chicago, 7/00; AAA Continuing Education, "Scheduling Damages and Discovery Management in Arbitration," Chicago, 5/00; presenter, AAA National Mediator Conference, Denver, 3/00; Harvard Law School Advanced Mediation Workshop, 2000; faculty, AAA Commercial Arbitrator Training, Atlanta, 11/98; AAA Construction Law Seminar, Chicago, 11/98; faculty, AAA Construction Industry Arbitrator Training, Chicago, 6/97; faculty, AAA Construction Mediator Workshop, Chicago, 5/97; Constructive Resolutions, Inc., Mediation Training, 1991; faculty, Chicago Region Arbitrator Training Programs; various other ADR training.

PROFESSIONAL ASSOCIATIONS: College of Commercial Arbitrators, President (2010-2011); American College of Real Estate Lawyers (Elected Fellow); American College of Construction Lawyers (Elected Fellow; Past President); Society of Illinois Construction Attorneys (Past President); Fellow, Association of Attorney Mediators; Chicago Bar Association (Real Property Committee, Past Chair; Alternative Dispute Resolution Committee; Construction and Mechanic's Lien Subcommittee); American Bar Association (Forum on Construction, Board of Governors); Builders Association of Greater Chicago (Board of Directors); American Subcontractors Association (Board of Directors; Governmental Relations Committee, Chair); Construction Financial Management Association (Chicago Chapter, Legal Counsel); Lambda Alpha Honorary Land Economics Society. Member CPR Panel of Distinguished Neutrals. International Mediation Institute (IMI) Certified.

HONORS: Recipient of ABA Forum on Construction Industry Cornerstone Award for Lifetime Achievement in the field of Construction Law (2004); Chambers USA, America’s Leading Lawyers for Business stated “rivals extol Stanley Sklar as “one of the preeminent construction law practitioners in the country.” Member of Lambda Alpha Honorary Land Economics Society and Leading Lawyer Network – Construction consisting of top 5% of lawyers in Illinois.

EDUCATION: University of Illinois, B.S. Industrial Administration, 1960; Northwestern University School of Law, J.D., 1964


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1. **Dispute Resolution Selection**

   All claims or disputes between the parties hereto arising out of or relating to this Contract or the breach thereof shall be decided as provided hereinafter. The parties agree that the sole method of resolving disputes will be mediation/arbitration as provided herein.

2. **Good Faith Negotiations/Mediation**

   Prior to mediation or arbitration, the parties shall try in good faith, to settle any disputes by negotiation between the parties. If the parties are unable to reach a negotiated settlement within 30 days, the parties agree that mediation shall be commenced in accordance with the Construction Industry Mediation Rules of the American Arbitration Association then in effect, unless the parties mutually agree otherwise. Either party may commence mediation proceedings by filing a Demand therefore with the American Arbitration Association office having jurisdiction thereof.

3. **Arbitration**

   In the event mediation is not successful, either party may commence arbitration proceedings with the American Arbitration Association office having jurisdiction thereof (or the regional office located in ______________ or such other place as the parties shall mutually agree in writing) by filing a Demand for arbitration in writing with the American Arbitration Association office having jurisdiction thereof, and by sending a copy of said Demand to the other party, within a reasonable time after the dispute has arisen. The arbitration proceedings shall be governed by and decided in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association, then in effect, unless the parties shall mutually agree otherwise, in writing.

   The Mediator may not be considered for appointment as an arbitrator in any future arbitration proceedings hereunder.

4. **Panel Selection**

   The panel to be selected shall be a balanced panel, consisting of one attorney, one contractor and one architect or licensed engineer. In any event, the attorney panel member shall be currently licensed to practice law in the state of Illinois, shall have actively engaged in the practice of law for at least 10 years, and in the immediately preceding five years, shall have devoted not less than 50% if his/her time to the practice of construction law and shall have demonstrated an expertise in the process of arbitration as an alternate dispute resolution method. Neither the contractor nor the architect or engineer selected for the panel shall have less than 10 years of experience in their field.

   The panel shall consist of three persons who have availability to allow the arbitration sessions to proceed on a continuous basis and the parties recognize that such a panel may require fees in excess of those suggested by the American Arbitration Association. One member shall be
a duly licensed attorney who has been engaged in the practice of law for not less than 10 years and the during the immediately preceding 5 years shall have devoted not less than 50% of his/her to construction matters and who shall be designated the Chair.

Any claim, which in the aggregate is equal to or less than $150,000 shall be submitted to single arbitrator panel. Any claim, which, in the aggregate shall exceed $150,000, shall be submitted to a balanced panel, consisting of one attorney, one contractor and one architect. In any event, the attorney panel member shall be currently licensed to practice law in the state of Illinois, shall have actively engaged in the practice of law for at least 10 years, and in the immediately preceding five years, shall have devoted not less than 50% of his/her time to the practice of construction law and shall have demonstrated an expertise in the process of arbitration as an alternate dispute resolution method.

5. **No Authority to Award Punitive Damages**

The arbitrator(s) shall have no authority to award punitive damages nor make any ruling, finding or award that does not conform to the terms and conditions of this agreement. The arbitrator(s) is authorized to award to the prevailing party, if any, as determined by the arbitrator(s), all or a part of its costs and fees. “Costs and fees” shall include the arbitrators’ fees, administrative expenses, witness fees and reasonable attorneys’ fees.

6. **Non-Disclosure**

Neither party nor the arbitrator(s) may disclose the results of any arbitration hereunder, without the prior written consent of the parties.

7. **Pre-Hearing Conference**

The arbitrator shall order a pre-hearing exchange of information by the parties, including production of requested documents reasonably required by the parties, exchange of summaries of testimony of proposed witnesses, the deposition of any experts and limited depositions of the parties. All issues regarding conformation with discovery requests shall be decided by the arbitrator(s).

The panel shall require a prehearing meeting between the parties at which each party shall present a memorandum disclosing the factual basis of its claim and defenses and disclosing legal issues raised. It shall also disclose the names of any expert a party may present as a witness in the proceedings. Failure to disclose such experts shall bar their testimony at the hearings.

8. **Discovery Rules**

Each party shall have the right to such discovery procedures as the Arbitrator(s) may determine to be reasonably necessary for a full understanding of any legitimate issue raised in the arbitration. Any reports, calculations and other data used by an expert in reaching his opinion and who is called as a witness shall be provided at least 10 days prior to such expert’s deposition.
9. Award of Fees and Costs to Prevailing Party

In the event of litigation or arbitration of any dispute arising under this agreement, the prevailing party will be entitled to recover all attorneys’ fees, filing fees, costs and related expenses from the non-prevailing party and such recovery shall be made part of any judgment or arbitration award.

10. Finality of Award

The Award rendered by the arbitrator(s) shall be final and binding upon the parties and judgment may be entered by any competent court having jurisdiction thereof.

11. Joinder/Consolidation

Arbitration proceedings under this agreement may be consolidated with arbitration proceedings pending between other parties if the proceedings arise out of the same transaction or relate to the same subject matter. Consolidation will be by order of the arbitrator(s), in any of the pending cases, or if the arbitrator fails to make such an order, any party may apply to any court of competent jurisdiction for such an order.

12. Governing Law

This contract shall be governed in accordance with the laws of the State of __________

13. Written Opinion

The Award of the arbitrator(s) shall be accompanied by a standard opinion as provided in AAA Construction Rules.

14. Non Consumer Transaction

The parties further agree that any claims arising out of this agreement shall not be subject to any AAA rules relating to consumer transactions.
Drafting The ADR Clause
For The Transactional
Attorney And Its Effect On
Litigators

“Every Contract Clause Has
Consequences (And Sometimes
Unintended Ones)”

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ADR – Truth vs. Fiction

- Arbitration Is On The Wane!
- Arbitration Takes Too Long!
- Rules Are Too Rigid!
- No Discovery Is Permitted!
- Arbitrators Always Render “Solomon” Decisions!
- Arbitration Is More Expensive Than Litigation!
- Trial By Ambush
- Prince Charming vs. Rambo

Private ADR

- Mediation
- Fact-Finding/Early Neutral Evaluation
  - Neutral
  - Expert
  - Neutral Expert
Private ADR

- Arbitration
- Binding
- Non-Binding – An Oxymoron
- Baseball/Final Offer
- High - Low
- Incentive
- Med/Arb
- Court-Annexed Mediation

Drafting the Right ADR Clause

- Client Considerations
  - Precedent or Formal Decision
  - Privacy vs. Public Forum
  - Preservation of Relationships
  - Resolution Timeliness or Vulnerability to Delay Tactics
  - Anticipated Trouble Spots with Contract
  - Potential Insurance Coverage or Limitations
    - Definitions For Coverage: “Claim” Or “Dispute” vs. “Action” Or “Lawsuit”

Drafting the Right ADR Clause

- Are Non-signatories Bound - e.g., Affiliates, Parent/sub, Successors
  - Consolidation
- Selecting The Neutrals
  - Number
    - One
    - 3-Arbitrator Panel
  - Skill/Background
    - Degrees/Licenses (Lawyer, CPA, P.E., Design Professional, Appraiser, Broker)
Drafting the Right ADR Clause

• Former Judge
• Experience/Expertise - Area Of Law/Business
• ADR Training/License/Certification
• Pool From Which Drawn - e.g., Member Of Professional Or Trade Association
  • Mechanics Of Appointment
    • Pre-dispute Selection Of Person(s)
    • Selection From Offered Panel
    • Party Appointed
    • Agree In Advance

• Appointment in Event of Default
• Ethics Issue – Disclosures, Conflicts
• Venue and Multi-Jurisdictional Practice
  • Logistics Of Proceeding
    • Venue and Multi-Jurisdictional Practice
    • Place - City, State - Careful:
      • Site - Offices/Board Rooms/Hotels
    • Length of Hearing Day

• Pre-Hearing and Hearing Procedures
  • Pleadings
    • Required v. Permitted
    • Formal Style Or Persuasive Narrative
  • Discovery
    • None v. Some v. Skies the Limit
    • Restrictive – Only Documents/No Interrogatories/Limited Depositions
    • Full Federal Rules Or State Rules
    • Forum Rules (i.e. AAA/CPR)
Drafting the Right ADR Clause

- Neutral Discretion
- Need For Confidentiality Agreements

Motion Practice
- Permitted Or Limited
- Dispositive Motions
- Lack Of Ability For Interlocutory Appeal

Drafting the Right ADR Clause

- Evidence Rules
  - Follow Federal/State
  - Loosened - e.g., Hearsay
  - Privileges Embraced
  - Relevance, Material, Reliable

Drafting the Right ADR Clause

- Hearing
  - Telephonic Evidence
  - Affidavits
  - Briefs
  - Record And Transcript
  - Limitation On Evidence
Drafting the Right ADR Clause

- Relief Awarded - Arbitration
  - Interim Relief (i.e. AAA R-36)
  - Injunctive Relief
  - Obligation to Follow Law v. Manifest Disregard of Law
- Exclusions - e.g. Injunctive, Punitive Damages, Consequential Damages, Specific Performance, Other (?)
- Extras
  - Attorneys' Fees To Prevailing Party
  - Interest
- Confirmation To Collect/Enforce
  - Court Filing For Confirmation of Arbitration Awards
  - File Breach of Contract if Unpaid Settlement/Mediation Agreement

Drafting the Right ADR Clause

- Arbitrator and Forum Costs
- Experts, Consultants
- Arbitrator Fees
- Confirmation To Collect/Enforce
  - Court Filing For Confirmation of Arbitration Awards
  - File Breach of Contract if Unpaid Settlement/Mediation Agreement

Drafting the Right ADR Clause

- Appeal or Court Motion for Vacatur - Arbitration
  - Exceed Authority; Incomplete Award
  - Bias Or Non-disclosure Of Conflict Of Interest
  - Abuse Of Arbitrator Discretion - Postponement Or Exclude Evidence
  - Procured By Fraud
  - Manifest Disregard Of Law
Drafting the Right ADR Clause

- Confidentiality
  - Particularly mediation
  - Statements made during arbitration - protective orders
  - Agreement/award

What's Wrong With This ADR Clause?

- Arbitration. Except for Tenant’s right to terminate under Paragraphs 4 and 5 (relating to use and termination) above, any claim, dispute or other matter in controversy which cannot be resolved privately (“Dispute”) concerning the matters covered by this Work Letter shall be resolved exclusively by arbitration administered by the American Arbitration Association (“AAA”) in the city where the Building is located or the closest city in which the AAA maintains an office.

- Arbitrations shall be governed by the Federal Arbitration Act, 9 U.S.C. §1 et seq., and administered under the AAA Commercial Arbitration Rules in effect on the date the Dispute is submitted to arbitration, except that the arbitrator shall be an architect experienced in tenant improvement design and construction or an experienced tenant improvement construction contractor, in each case as appropriate to the matter in dispute, and, in either case, such arbitrators will be professionally licensed or certified to practice in their respective fields by the State in which the Building is located.
What’s Wrong With This ADR Clause?

- If the parties cannot agree on a mutually acceptable single arbitrator from the one or more lists submitted by the AAA, the AAA shall designate a minimum of three (3) persons, who, in its opinion, meet the criteria set forth herein. Each party shall be entitled to strike one of such designees on a peremptory basis, indicating its order of preference with respect to the remaining designees, and the selection of the arbitrator shall be made from among such designees not so stricken by either party in accordance with their indicated order of mutual preference.

What’s Wrong With This ADR Clause?

- The arbitrator shall base the arbitration award on accepted design and construction industry customs and practices, applicable law and judicial precedent and, unless both parties agree otherwise, shall include in such award the findings of fact and conclusions of law or industry practice upon which the award is based. Judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof. The prevailing party in the arbitration shall be entitled to reasonable attorneys’ fees and expenses incurred in the resolution of said Dispute.

What’s Wrong With This ADR Clause?

- Any controversy, dispute or claim arising out of or in connection with interpretation, performance or breach of this Agreement which cannot otherwise be resolved between the parties shall be resolved expediently and with the least possible cost and therefore agree to submit the foregoing to an impartial arbitrator. If any part of this section shall be held to be unenforceable, its unenforceability shall not affect the obligation to arbitrate thereunder.
What’s Wrong With This ADR Clause?

- Duty to arbitrate shall extend to any officer, shareholder, principal, agent, trustee, third-party beneficiary, guarantor or non-signatory to this Agreement.

What’s Wrong With This ADR Clause?

- Arbitration shall be submitted within 30 days after the dispute arose and failure to do so shall constitute a waiver of all rights to raise any claims in any forum and such limitation shall not be subject to tolling, legal, equitable or otherwise.

What’s Wrong With This ADR Clause?

- The dispute shall be submitted to AAA which will appoint the arbitrator.
- All disputes will be resolved either by a single arbitrator or a panel of three, as determined by the company, in its sole discretion.
- The panel shall be knowledgeable regarding and have experience as arbitrators of commercial disputes.
What’s Wrong With This ADR Clause?

- Arbitration shall be conducted pursuant to AAA and applicable dispute resolution rules of AAA in effect at the time the demand for arbitration is made.

What’s Wrong With This ADR Clause?

- The matter shall be heard within 45 days of filing of the claim and shall be concluded within 2 days.
- Arbitrator shall have no authority to award punitive damages or consequential damages or issue injunctive relief or specific performance.

What’s Wrong With This ADR Clause?

- There shall be no discovery.
- Discovery shall be in accordance with applicable civil discovery rules as a court of competent jurisdiction in state where the proceedings are to be heard, including all pre-trial discovery.
What’s Wrong With This ADR Clause?

- The arbitrators shall be bound by the Federal Rules of Evidence and Federal Rules of Civil Procedure
- Arbitrator shall have sole discretion to the amount and extent of pre-hearing discovery which is appropriate

What’s Wrong With This ADR Clause?

- Any award shall be issued within 30 days of the closing of hearings
- Arbitrator will provide an Award with Findings of Fact and Conclusions of Law

What’s Wrong With This ADR Clause?

- Each party shall bear its own attorney’s fees and other costs
- The prevailing party shall be entitled to recover its attorney’s fees and other costs