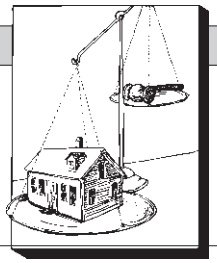
Settling Out of Court



by Timothy Fisher

There has never been a construction project without disputes. Fortunately, most disputes get resolved without lawyers, courts, or arbitration. Sometimes, however, the problem is too big, or one of the parties is too unreasonable to come to the negotiation table. When this happens, the legal and court costs can be considerable, and in the end the parties often wish they had settled earlier. This article describes the different arrangements contractors and owners can use to negotiate settlements to construction disputes before they reach the courtroom or arbitration table.

Why Settle Out of Court?

In construction more than almost any other area, a negotiated settlement usually produces a much better outcome than one decided in the courts. This is because construction disputes have such complex facts. To teach a lawyer your entire case and then have the lawyer teach the judge, jury, or arbitrator is extremely time-consuming and costly. Also, most construction disputes are resolved on common-sense grounds, not legal niceties. You don't need courts to do that for you. So whenever possible, you should settle rather than litigate or arbitrate a construction dispute.

The arrangements that can be used to settle a dispute range from the simple to the exotic. Generally speaking, simpler solutions are more reliable and should be used whenever possible. Sometimes, however, an element of creativity is necessary to make a deal work. In those cases you can consider using some of the more complex approaches described in this article. We'll start with the simple ones.

Disputes Involving Two Parties

Most disputes involving two parties can be settled as long as some goodwill and trust remain.

Payment and release. The simplest settlement is a payment of money in return for release of the claim. The only questions that need be answered in structuring the settlement are the date and amount of the payment and the scope of the release. A release can surrender just one claim, all claims from an entire project, or all claims of any nature (called a general release).

Further work or transfer of property. Sometimes the parties cannot agree on a dollar figure, but one side has something, such as goods or services, valued by the other. For example, on a project on which work has stopped, the contractor may agree to finish the job or turn over materials in return for payment. This kind of settlement works well in appropriate cases, but requires trust. In the example just mentioned, for instance, the owner must have confidence that the additional work or materials will be of fair quality, and the contractor must believe the owner will not make bad faith claims about the work.

Often an escrow account is set up to hold the settlement funds until the work is performed or material is delivered. When that is done, some arrangement must be made to decide when the funds come out of escrow. The simplest arrangement is a joint checking account that requires both parties to agree that the funds may be released. If the parties do not trust each other, however, they can hire a third person—for example, an engineer—to review the situation and decide whether the funds should be released.

Payment plus clarification of future relationship. This arrangement is often used where a developer regularly uses the same contractor for repeat projects. If the contractor asserts a claim early in the relationship that the developer feels is unjustified, the developer can choose to pay that claim in return for a written promise by the contractor not to assert that sort of claim again. This settlement compensates the contractor for the unanticipated loss while protecting the developer from similar claims in the future.

Settling by agreeing to mediation. Sometimes parties simply cannot agree on any settlement, but still want to settle without litigation. In such cases they can bring in a neutral mediator as a sounding board and guide. Unlike arbitration (see The Legal Column, 5/89 and 6/89), mediation is not binding—that is, the parties aren't bound to abide by the mediator's recommendation. The American Arbitration Association offers mediation services, and private dispute resolution firms in many cities also offer the service.

Disputes Involving Three Parties

Some disputes between owner and contractor are caused in part by other parties' actions. Having a third party involved in a dispute can complicate matters, but it doesn't mean the conflicts can't be worked out. The main question is whether to separate the different conflicts from each other or link them.

Separate, non-linked agreements. A common example of a construction conflict involving a third party is an architectural design error that requires extra work from the contractor. While the owner is generally responsible for the design, he or she may be reluctant to pay the contractor for the extra work before knowing how much compensation to expect from the architect. The same situation in reverse can arise when a contractor is held responsible for bad work performed by a subcontractor.

In such cases, the third party does not need to be brought into the settlement negotiations between the two principle parties. In the design error situation, for example, the burden falls on the owner, who should approach the architect separately to determine what contribution he or she can count on towards the payment due the contractor, then work out an agreement with the contractor. The two arrangements do not technically depend on each other.

The earlier a dispute is settled (with or without lawyers), the easier it will be, because the trust between the two parties will still be intact.

"Mary Carter" arrangements. "Mary Carter" deals are a more complicated approach to settling three-way disputes. The name comes from a major lawsuit in which the court held these arrangements to be legal and binding. A typical situation that could be settled by a Mary Carter deal would be where a subcontractor has claims against a general contractor—such as for extra work—and the general contractor in turn asserts the same claim against the owner. The general contractor is trying to avoid any liability of his own, hoping to act instead as a "pass through," perhaps even getting a mark-up on any claim the owner pays the sub.

However, the general contractor himself may be responsible for part of the claim (due to poor coordination of subs, for example)—and the owner may know that and refuse to pay the full amount the sub is seeking. If the general contractor refuses to cooperate in settling the dispute, it is still possible for the sub and owner to settle. The owner pays the sub for a portion of his total claim, in return for which the sub agrees to continue to seek the rest of the money from the general contractor, and also to reimburse the owner for any charges the general contractor subsequently makes to cover his share.

For example, suppose a subcontractor makes a claim against the owner for $10,000, of which $7,000 is extra work added to the general contract, but $3,000 of which was caused by the general contractor's coordination problems. If the general contractor refuses to participate in a settlement, the owner can still settle with the sub by paying him $7,000 for the extra work. The sub will then seek the other $3,000 from the contractor, promising meanwhile to compensate the owner for any charges the contractor makes to pass on the rest of the sub's claims. That is, if the contractor pays the sub the $3,000 but then succeeds in passing it on to the owner, the sub will pay the owner back out of his own recovery from the contractor.

This arrangement protects both owner and sub: the sub is guaranteed at least the owner's $7,000 settlement, and the owner is assured no greater exposure than the $7,000 he already paid.

Conclusion

The more exotic settlement structures described here require a lawyer. However, contractors and owners experienced in settling disputes can often do an adequate job of documenting the deal themselves, particularly with the simpler strategies. If you're considering using a lawyer to document or look over the agreement, you have to balance cost against caution: the sooner a lawyer becomes involved, the less risk there is that you will make a mistake, but you may pay more in fees.

Generally speaking, the earlier a dispute is settled (with or without lawyers), the easier it will be, because the trust between the two parties will still be intact.

Most important to remember is that in order to settle, you will need to know your case better than you will if you litigate it. In settlement discussions (especially in mediation or intense face-to-face settlement meetings), there is usually little time to go back and do additional preparation between sessions, and you need to be able to make quick but sound decisions regarding the strengths and weaknesses of your case. If you can make those decisions rationally, you can save enormous costs by ending the dispute early. ■

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