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A look at arbitration clauses and mechanics lien laws

By Celeste M. Hammond
and Virginia M. Harding

Warning: Matters discussed in this article may surprise some owners. For decades many owners (and contractors) have viewed binding arbitration clauses in construction contracts as sparing them a trip to the courthouse to resolve construction disputes. This reluctance to litigate was often grounded in unsatisfactory prior experiences with the judicial system. The perceived costs, delays, risks and uncertainties of the court system resulted in a documented decrease in litigation and an increasing use of arbitration to resolve disputes.

Owners may be surprised to learn: That binding arbitration clauses in construction contracts may not spare them from having to go to court to resolve disputes with their contractors; that arbitration clauses in construction contracts do not take away the contractor's rights to file mechanics liens, which are foreclosed in judicial proceedings; that the right to have a dispute resolved by arbitration can be inadvertently waived; and that since 2007 the American Institute of Architects (AIA) construction documents have included a provision which makes litigation rather than arbitration the default mechanism for resolving disputes.

Bruce Jervis' June 10, 2010 article "Tension Between Arbitration and Mechanic's Lien Rights" ([//constructionadvisorstodayout.com/2010/06](http://constructionadvisorstodayout.com/2010/06)) notes that there is a tension between the contractual right to use arbitration to settle and resolve construction disputes and the contractor's statutory right to file a mechanic's lien on the owner's property to secure its right to be paid. The source of this tension lies in the fact that while arbitration is a non-judicial process, the enforcement of mechanics lien claims requires a judicial process, an equitable action to foreclose the mechanics lien.

Mechanics liens are statutory in nature and mechanics lien acts set forth the requirements which a contractor must strictly follow in order to file, perfect and foreclose a lien claim. As a matter of public policy, construction con-

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tracts cannot include provisions whereby contractors agree to waive their mechanics lien rights or to preempt the equity court's jurisdiction to foreclose.

The right to have disputes settled by arbitration is a contractual right and arises only because the owner and the contractor have agreed to include such a provision. Since 1888, when AIA's predecessor organizations first adopted forms of owner-contractor contracts, these contracts have provided for binding arbitration to resolve disputes between owners and contractors.

This continued to be the case until AIA issued new design-build contracts in 2004 that gave the parties the right to select and designate the method by which disputes would be resolved by checking a box. The revised AIA Construction Forms released in November 2007 continued to utilize a check-box format that made litigation the default dispute mechanism unless the box for arbitration or the box for "other" specified dispute resolution mechanism was checked.

Even prior to AIA's decision to revise its form documents to give owners and contractors the ability to select their method for resolving disputes, not all owners and contractors were willing to have their contract disputes settled by arbitration. These owners and contractors routinely directed their attorneys to strike and delete arbitration clauses from construction contracts because of their unwillingness to have a non-judicial process resolve their disputes. For disputes arising under such contracts, the entire matter would be resolved in the courts.

In a recent article, "Arbitration: The New Litigation," (2010 U. ILL. Rev. 1-59 2010) Thomas J. Stipanowich, professor and director of the Straus Institute of Dispute Resolution at Pepperdine University School of Law argues that as litigators become more involved in ar-

bitrations, arbitration has become just as protracted, expensive and uncertain as litigation. He further notes that arbitration often falls short of expectations. In light of the significant change in AIA construction documents, it remains to be seen whether there will be a reduction in use of arbitration for construction disputes.

The decision earlier this year by the Illinois Appellate Court (2nd District) in *Illinois Concrete-I.C.I., Inc. v. Storefitters, Inc.* provides a warning that at least in the 2nd District arbitration rights can be waived by conduct inconsistent with arbitration rights. In this case, the contractor filed a lien on the owner's property. In response, the owner – without taking action to initiate arbitration proceedings under the contract's arbitration clause – sent notice under Section 34 of the Illinois Mechanics Lien Act demanding that the contractor file suit within 30 days after notice to foreclose its lien. Since failure to bring such an action within 30 days will result in the lien being forfeited, to protect its lien, the contractor filed a foreclosure action. The owner then came to court requesting — for the first time — that the trial judge send the dispute to arbitration in accord with its contract with the contractor. The owner's request was denied by the trial court with the Appellate Court upholding the trial court's decision.

The result in *Illinois Concrete* is unlike the result in the 3rd District's decision in *LaHood v. Central Illinois Construction, Inc.* (unpublished 2002 opinion) which preserved the contractor's right to both file suit to foreclose a mechanics lien and have the dispute resolved through arbitration. Unlike *Illinois Concrete*, a notice for the initiation of arbitration proceedings was given before the Section 34 notice was sent and suit was filed by the contractor. In *LaHood*, after suit was filed, a stay of proceedings was requested and granted to allow the dispute to be resolved through arbitration.

According to Eric P. Sparks (Gould & Ratner LLP) "while the result in *Illinois Concrete* is not a surprise to the mechanics lien bar, it is a timely reminder to all owners and contractors that the right to resolve construction contract disputes using the binding arbitration provisions in construction contracts can be waived by the conduct of the parties. Thus when exercising rights under the mechanics lien act, special care must be taken to preserve one's right to resolve disputes with arbitration."

Celeste M. Hammond is a professor and director of the Center for Real Estate Law for The John Marshall Law School and can be reached at Thammond@jmls.edu. Virginia M. Harding is of counsel at Gould & Ratner LLP and is a member of the adjunct faculty at John Marshall. She can be reached at vharding@gouldratner.com.