

Arbitration Provision of Prime Contract Incorporated by Reference into Subcontract, Requiring Subcontractor to Arbitrate its Claims

A subcontractor sued the general contractor (GC) and project owner to enforce liens it put on the property for non-payment. The defendants filed a motion to compel arbitration. Court held that the arbitration provisions of the prime agreement were incorporated by reference into the subcontract, thereby requiring the subcontractor to first seek mediation and then ultimately resolve disputes through arbitration instead of litigation. *Frohberg Electric Company, Inc. v. Grossenberg Implement, Inc.*, 297 Neb. 356 (Nebraska 2017).

The general contract included a mandatory arbitration clause for “any Claim ... not resolved by mediation pursuant to [the general conditions].” The general contract was also referenced in several sections of the subcontract, including one (Section 11) in which Subcontractor agreed “[t]o be bound to ... Contractor by the terms of the General Contract” and “to conform to and to comply with the provisions of the General Contract.” Another section (Section E), under the heading “The Contractor Agrees as Follows,” provided: “If arbitration of disputes is provided for in the General Contract, any dispute arising between ... Contractor and ... Subcontractor under this

Subcontract, including the breach thereof, shall be settled by arbitration in the manner provided for in the General Contract.”

In arguing that this Section didn’t apply to it, the subcontractor asserted that the title was “The Contractor Agrees...” instead of the “Subcontractor Agrees....” This was apparently a typographical error in the contract. It was obvious to the court that the intent was for this to apply to the subcontractor regardless of the wording of the subheading. In any event, the court explained that subtitles in contracts don’t take precedence over or change the content in the text that follows.

In reviewing the trial court decision the appellate court explained, “The district court determined that *Subcontractor’s* claims were not subject to arbitration. By purportedly enforcing the express terms of the contract, the court concluded that Section E was binding on Contractor only. In doing so, the district court adopted a restrictive interpretation of the section.”

The appellate court stated,

“While two conflicting interpretations of Section E can be advanced, only one of them is reasonable. The district court’s restrictive interpretation disregards Section E’s broad language and effectively rewrites the section by limiting its applicability to those disputes complained of by Contractor and not Subcontractor. A contract is ambiguous when a word, phrase, or provision in the contract has, or is susceptible of, at least two *reasonable* but conflicting interpretations or meanings. Because the restrictive interpretation of Section E was unreasonable, Section E was unambiguous and should have been enforced by its express terms.”

The court accordingly reversed the trial court and held that the subcontractor must adhere to the alternative dispute process set forth

in the contract, including the requirement that it must first submit the matter to mediation and then to arbitration in the event that mediation fails.

Comment: The decision provides a good example of the importance of the incorporation by reference or flow down clauses in the subcontract. A subcontractor is bound by the terms of the prime contract that it agrees to have incorporated into its contract. If it takes issue with any of the prime contract clauses that are going to be applied to it, the subcontractor must take exception to those clauses during contract negotiations.

In this case, if it was important to the subcontractor that disputes be resolved through litigation instead of arbitration it needed to negotiate that into the subcontract to take precedence over the arbitration provisions in the prime agreement. As a practical matter, however, if the prime contractor was bound by a requirement to arbitrate its disputes with the project owner, it would not be likely to agree to litigate disputes with a subcontractor. It would be judicially inefficient and costly to have separate arbitration and litigation where the parties and issues could not be consolidated into a single forum for dispute resolution.

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