JONES DAY

OCTOBER 2014

COMMENTARY

Arbitration for One is Not Arbitration for All: Sixth Circuit Allows Lawsuit Against Indirect Parties Following Consolidated Arbitration

Recently, the U.S. Court of Appeals for the Sixth Circuit allowed a subcontractor's lawsuit against design professionals to proceed even though all parties had previously participated in a consolidated arbitration proceeding over the same issues. *W.J. O'Neil Co. v. Shepley, Bulfinch, Richardson & Abbott, Inc.*, No. 12-2320, 2014 U.S. App. LEXIS 16607 (6th Cir. Aug. 28, 2014). The design professionals were brought into the arbitration via indemnification claims by the owner, and there was no arbitration agreement between the subcontractor and the design professionals. Given this, the court found that the subcontractor's claims against the designers were not a part of the arbitration and not barred by *res judicata.* The court applied a technical approach to *res judicata* based on the principle that a party cannot be forced to arbitrate a claim against another party with whom it has not agreed to arbitrate.

The *O'Neil* decision is potentially significant for any consolidated construction arbitrations involving additional parties added through indemnification claims. Whether a contractor, project manager, or design professional, *O'Neil* holds that arbitration is binding and final only as to the parties who agreed to arbitrate the claims that are subject to arbitration. The result highlights the fact that the same claims may have to be relitigated *in their entirety* in a second proceeding—depriving everyone of a sense of finality. The risk of multiple proceedings and increased costs should be considered in determining how to proceed in a consolidated arbitration proceeding and how to draft arbitration clauses to minimize the risk of repeatedly litigating the same claims.

Background of *O'Neil*

This lawsuit arose out of the construction of the Cardiovascular Center Hospital at the University of Michigan, Ann Arbor (the "University"). To design the hospital, the University hired the architecture firm Shepley, Bulfinch, Richardson & Abbott, Inc. ("SBRA"). In turn, SBRA retained Smith Seckman Reid, Inc. ("SSR") as the design consultant for certain hospital systems. Separately, the University contracted with the Barton Malow Company as its construction manager at-risk for the project. Barton Malow then subcontracted with

W.J. O'Neil Company to serve as the mechanical contractor. Each of these four agreements contained a broad arbitration clause and various indemnity obligations.

To obtain damages resulting from numerous delays in the hospital's construction, in October 2006, O'Neil filed a lawsuit against Barton Malow and the designers, SBRA and SSR. Based on the arbitration clause in its contract with O'Neil, Barton Malow successfully moved to compel arbitration of O'Neil's claims against it. The court stayed and eventually dismissed without prejudice O'Neil's claims against the designers and ruled that the statute of limitations was tolled during the subsequent arbitration proceedings.

O'Neil then initiated arbitration against Barton Marlow in February 2007, alleging breach and abandonment of contract. Barton Marlow responded by filing an arbitration demand against the University for indemnity, on the basis that any amount owed O'Neil was due to design errors by the University's designers. These two arbitration proceedings were consolidated. Once consolidated, the University then filed an indemnification demand against SBRA, which in turn filed a demand for indemnification against SSR, adding both designers to the consolidated proceeding. Despite O'Neil's allegations regarding the inadequacy of the designers' work, O'Neil never pursued claims against the University or designers in the consolidated arbitration and, of course, never had a contract or arbitration agreement with those entities.

The consolidated arbitration lasted more than three years and eventually concluded in August 2010. Ultimately, the arbitrators awarded O'Neil $2.4 million plus interest on its claims against Barton Malow. The arbitrators also rejected Barton Malow's indemnity claims against the University; therefore, the pass-down indemnity claims (by the University against SBRA and by SBRA against SSR) were moot. No party moved to have a court enforce or recognize the arbitration award.

With its claims against the designers no longer tolled due to the arbitration's conclusion, O'Neil quickly filed suit in May 2011 against the designers in Michigan federal court, alleging professional negligence, tortious interference, and innocent misrepresentation by the design firms. The designers jointly moved to dismiss O'Neil's claims, arguing that they were barred under the doctrine of *res judicata* due to the consolidated arbitration proceedings. The trial court granted the designers' motions and dismissed O'Neil's claims. O'Neil appealed, arguing that its claims were not barred under *res judicata* as it did not, could not, and was not required to pursue claims against the designers in the consolidated arbitration.

Application of *Res Judicata* to Claims Not Subject to the Arbitration

On appeal, the court characterized the case as one of first impression, freeing it to examine various legal principles and theories underlying the scope of arbitrations. The court started with the basic premise that arbitrators derive authority only from contracts between the parties and cannot decide a claim that the parties have not mutually agreed to arbitrate. *O'Neil* at *10-11. Because of this, "[i]t makes little sense to allow an arbitration proceeding or award to preclude a claim the arbitrator had no authority to decide," as doing so would force a party "either to arbitrate a claim it had not agreed to arbitrate, or to effectively give up the claim." *O'Neil* at *11. The court also noted that the Restatement of Judgments supports this analysis, stating that "a valid and final award by arbitration has the same effects under the rules of *res judicata,* subject to the same exceptions and qualifications, as a judgment of a court" and "the terms of these rules may more often result in denying preclusive effect to determinations reached in arbitration proceedings." *O'Neil* at *14 (quoting Restatement (Second) of Judgments § 84(1), cmt. f. (1982)).

In examining whether O'Neil agreed to arbitrate the claims at issue, the court rejected the defendants' proposed "contagion" theory that O'Neil was required to arbitrate due to the shared chain of arbitration agreements among the parties to the dispute. *O'Neil* at *17-18. Accordingly, the court saw the only issue as whether the contract between O'Neil and Barton Malow required O'Neil to submit its claims against the designers to arbitration. On this issue, the court interpreted the contract's arbitration provision to answer "no":

> The contract appears to require O'Neil to consent to be joined to the consolidated arbitration and be bound by the "procedures, decisions and determinations" resulting from the arbitration. But even if the consolidated arbitration included O'Neil and the defendants

> [designers], the contract does not require O'Neil to raise and arbitrate claims against the defendants or forever lose those claims.

O'Neil at *17.

Because O'Neil's claims could not have been raised in the arbitration without a separate agreement with the designers to arbitrate, *res judicata* did not apply. This view of *res judicata* appears principally grounded in ensuring a right to an adequate forum, at the potential cost of duplicative litigation. Moreover, because "arbitration is premised on a contract, and '[i]t goes without saying that a contract cannot bind a nonparty,'" the court appeared to acknowledge the potential that a party could withhold consent to arbitrate within the context of the consolidated arbitration if it believed the claims were not subject to an arbitration agreement, and later seek to pursue the claims in litigation if a satisfactory outcome was not reached in the arbitration. Further, what is not specifically addressed in the court's opinion, but logically follows, is that O'Neil likely will not be able to use offensive collateral estoppel to pursue its claims.

Practical Implications

Often characterized as a tool to achieve efficient and final resolution of commercial disputes, construction arbitration has seen increased scrutiny in recent years by some commentators, citing arbitrator fees and prolonged discovery as putting its cost-effectiveness over litigation in doubt, e.g., James P. Wiezel, "Cost-Effective Construction Arbitration," *The Construction Lawyer*, Volume 31, Number 2, Spring 2011. *O'Neil* will certainly raise additional questions regarding the drafting of arbitration agreements. Situations in which there may be multiple claims against multiple parties that are not all in contractual privity with each other may require more creative drafting and thought at the outset of the project, particularly with respect to the terms of consolidated arbitration agreements.

Absent more careful drafting at the front end, how could the designers here have avoided this result? Perhaps their best choice would have been to invite O'Neil to assert its direct claims against the designers in the consolidated arbitration, in order to avoid the risk of having to litigate them separately later. Presumably, few parties would want to litigate a claim twice in two different forums over the same subject matter, so likely O'Neil would have agreed. But, of course, it is not exactly standard procedure to invite the assertion of additional claims against oneself, and that decision would involve a careful balancing of the relative risks.

Conclusion

Overall, *O'Neil* stands for the proposition that arbitration is limited to those claims a party has agreed to arbitrate, and courts remain open for additional claims regardless of whether they cover the same subject matter or involve the same parties found in the arbitration. While this provides potential plaintiffs with reassurances that they can pursue future claims on their own terms, the threat of duplicative adjudication and potential "double-dipping" presents issues to both sides, including increased costs.

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