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'Mandatory' Arbitration of Construction Disputes Under NY's Prompt Payment Act

Christopher A. Gorman, *New York Law Journal*

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Payment disputes between owners and contractors and contractors and subcontractors arise frequently in connection with commercial construction projects. Such disputes often result in time-consuming and costly litigation between the parties. In 2003, the New York state legislature enacted a remedial legislative scheme known as the Prompt Payment Act (the PPA) which was intended to provide some clarity to such disputes—and afford certain protections to contractors and subcontractors who are not being paid despite having provided services as required pursuant to construction contracts. As detailed below, the legislative scheme was intended to, among other things, facilitate resolution of disputes arising between owners and contractors and contractors and subcontractors in connection with certain commercial construction projects. Recent authority interpreting the PPA has shown that courts are more than willing to enforce the statute's provisions to ensure a speedy resolution of disputes.

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The PPA, which first became effective in 2003, is contained in §§756-758 of Article 35-E of the General Business Law. The stated "policy and purpose" of the PPA is "to expedite payment of all monies owed to those who perform contracting services pursuant to construction contracts."

As detailed below, the PPA is unique in that it contains provisions which trump the freedom of contract rights of certain parties to construction contracts falling within the ambit of the PPA. Of particular significance for this article is a provision of the PPA which provides that a contractual provision precluding the parties from referring their dispute to expedited arbitration in accordance with the terms of the PPA is "void and unenforceable." Although the PPA has been in effect for more than a decade, it has not engendered a substantial volume of litigation. However, a recent decision of the Appellate Division, Third Department, interpreting the PPA's requirement that a construction contract may not limit the parties' right to refer a dispute to arbitration, *In re Arbitration Between Capital Siding & Construction*, 138 A.D.3d 1265 (3d Dep't 2016) (*Capital Siding*), sheds some light on the extent to which courts are willing to go to interpret the PPA in such a way as to ensure that an aggrieved contractor or subcontractor seeking payment can vindicate its rights to payment in as expeditious a manner as is possible.

Overview of Relevant PPA Provisions

The PPA applies to certain private commercial construction projects involving agreements with general contractors, subcontractors and material suppliers where the aggregate contract price is equal to or exceeds \$150,000.

The PPA provides a statutory scheme which is intended to dictate, among other things, the way in which a contractor's or subcontractor's invoices are paid, the manner in which such invoices are to be approved or disapproved, and the contractor's or subcontractor's remedies in the event that an invoice is not paid.

New York General Business Law §756-b spells out the procedure in the event a dispute arises involving a potential breach of the PPA. Section 756-b(3)(a) provides that, upon receipt of written notice of a complaint alleging a violation of the provisions of the PPA, "the parties shall attempt to resolve the matter giving rise to such complaint." Section 756-b(3)(c)

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states that, "[i]f efforts to resolve such matter to the satisfaction of all parties are unsuccessful, the aggrieved party may refer the matter, not less than fifteen days of the receipt of third party verification of delivery of the complaint, to the American Arbitration Association for an expedited arbitration pursuant to the Rules of the American Arbitration Association."

Most relevant for present purposes are the limitations that the PPA imposes on the ability of parties to a construction contract falling within the ambit of the PPA to agree to waive certain rights provided by the PPA. The PPA contains a provision which states that, "[e]xcept as otherwise provided in this article," the terms and conditions of the parties' written agreements will supersede the PPA's provisions. New York General Business Law §757 sets forth a number of the exceptions to this provision of the PPA, i.e., the provisions of the statutory scheme which can expressly trump the terms and conditions of the parties' construction contract. Specifically, §757 of the PPA contains a series of provisions which, if included in "construction contracts" falling within the ambit of the PPA, "shall be void and unenforceable." For instance, §757 generally renders "void and unenforceable," with limited exceptions, a provision in a construction contract



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"that makes the contract subject to the laws of another state or that requires any litigation, arbitration or other dispute resolution proceeding arising from the contract to be conducted in another state." Also "void and unenforceable" under §757 is a provision in a construction contract "stating that a party to the contract cannot suspend performance under the contract if another party to the contract fails to make prompt payments under the contract," which restriction appears to have been implemented in order to preserve the remedy afforded to contractors and subcontractors under the PPA to stop work if they are not being paid under certain defined circumstances.

One limitation in particular—subsection (3) of §757—is the focus of this article in light of the interpretation recently afforded this statutory provision by the Third Department in the *Capital Siding* decision referenced above. Section 757(3) states that a provision in a construction contract falling within the ambit of the PPA providing that a provision in a construction contract "stating that expedited arbitration as expressly provided for and in the manner established by section seven hundred fifty-six-b of this article is unavailable to one or both parties" is "void and unenforceable."

'Capital Siding' Decision

In *Capital Siding*, the petitioner, a contractor, made an application to the Supreme Court pursuant to CPLR 7503 to permanently stay an arbitration between it and respondent, an entity that was the petitioner's subcontractor in connection with a commercial construction project. The contractor and the subcontractor had entered into a construction contract in connection with a commercial construction project, and a dispute arose between the parties under the contract when the contractor withheld certain payments from the subcontractor. The subcontractor sought expedited arbitration pursuant to the PPA. The contractor, in response, commenced a proceeding in the Supreme Court seeking to permanently stay the arbitration on the ground that §6.2 of the



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parties' construction contract "expressly states that litigation, not arbitration, is the parties' chosen method of dispute resolution." The Supreme Court denied the contractor's application to stay the arbitration, interpreting the PPA to render the construction contract's dispute resolution provision void and unenforceable under §757 of the PPA because it denied the subcontractor the option to arbitrate the payment dispute.

The contractor appealed and, on appeal, the Third Department affirmed the Supreme Court's decision. The contractor's position on appeal was that "the PPA expressly provides that the subcontract's dispute resolution provision supersedes the PPA's requirement that expedited arbitration be available to an aggrieved party, and that it is unaffected by the '[e]xcept as otherwise provided' language of General Business Law §756-a."

After reciting the purpose of the PPA's statutory scheme and summarizing some of the statute's relevant provisions, the Third Department focused its attention upon §757(3) of the PPA as the basis for rejecting the contractor's argument. In rejecting the contractor's argument, the Third Department described §757(3) of the PPA as "specifically direct[ing] that '[a] provision, covenant, clause or understanding in, collateral to or affecting a construction contract stating that expedited arbitration as expressly provided for and in the manner established by [General Business Law §756-b] is unavailable to one or both parties is 'void and unenforceable.'" The Third Department rejected the contractor's "reading of the PPA," concluding that it "ignores the existence of General Business Law §757(3), which ... unambiguously voids and renders unenforceable any contractual provision that makes expedited arbitration unavailable to one or both parties." The Third Department held that, contrary to the contractor's argument, "the obvious function of section 6.2 of the subcontract is to establish litigation as the sole legal option for the resolution of disputes under the subcontract which, in turn, denies both parties the opportunity to arbitrate such claims." The Third Department concluded, therefore, that "[i]nasmuch as General Business Law §757(3) clearly operates to void and render unenforceable the subcontract's dispute resolution provision," the Supreme Court correctly denied the contractor's application to stay the arbitration.

Significance of Decision

Section 757(3) of the PPA, when read in conjunction with the Third Department's *Capital Siding* decision, has significant import for practitioners servicing clients in the construction industry—both in connection with negotiating construction contracts and in connection with litigating disputes arising from such construction contracts.

As an initial matter, *Capital Siding* makes clear that, at least when dealing with commercial construction contracts falling within the ambit of the PPA, expedited arbitration is always, regardless of the terms of the parties' agreement, going to be an available remedy for a party allegedly aggrieved under the terms of the construction contract. *Capital Siding* makes clear that parties to a construction contract cannot negotiate their contract in such a way as to work around §757(3) of the PPA. Indeed, in *Capital Siding* the Third Department made clear that, even if the parties include in a construction contract a mandatory venue provision laying venue in the event of a dispute in a state or federal court, a party allegedly aggrieved under the construction contract can always commence an arbitration in accordance with the PPA regardless of the terms of the parties' contract. *Capital Siding*, therefore, casts considerable doubt on any provision in a construction contract falling within the ambit of the PPA requiring that any dispute arising from the agreement must be litigated in a state or federal court.

Of course, such a result is good news for those who prefer having their construction disputes heard in an arbitration forum, as opposed to court. But *Capital Siding* raised an issue—without deciding it—of which those who prefer arbitration as a forum for the hearing of disputes arising from construction contracts need to be aware. Specifically, in *Capital Siding*, the contractor that was seeking to have the arbitration stayed and the dispute heard in court argued that the "Supreme Court's reading of the PPA violates its ... constitutional right to a jury trial." The Third Department, however, declined to decide this issue in the *Capital Siding* decision for several different procedural reasons, including that the contractor "admittedly raised th[e] issue for the first time on appeal" and, thus, it was deemed "unpreserved" for the appellate court's review.

Even though the Third Department was not apparently inclined to address the right to jury trial issue in *Capital Siding*, practitioners drafting construction contracts that would prefer to have their disputes resolved in an arbitration forum should

nonetheless be aware of the issue so that they can include a strongly worded waiver of the right to a jury trial provision in their construction contracts. While no court has yet decided whether such a waiver provision would be sufficient to withstand a constitutional challenge to the statute, at a minimum, such a waiver would provide a much stronger argument that the PPA's "mandatory" arbitration provision in §757(3) of the statute does not in fact violate the constitutional right to trial by jury.

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