



How direct benefits estoppel may impact your commercial construction contracts.

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Businesses love arbitration. They love that it provides — or attempts to provide — a speedy, cost-efficient and confidential means to resolve commercial disputes. As a result, more and more companies are including arbitration provisions in their contract documents.

This is critically important because arbitration is fundamentally a creature of contract. Thus, unless the parties enter into a contract agreeing to arbitrate their disputes, neither party is required to arbitrate — in most cases.

This month, we take a look at an exception to this rule: the legal concept known as direct benefits estoppel. Recognized by the most states, direct benefits estoppel allows a party to require a non-signatory to a contract to participate in arbitration.

To understand direct benefits estoppel and how it may impact your agreements — with or without an arbitration provision — let's look at a real example that unfolded in the construction context about five years ago. In

WBCM, LLC v. BCC Properties, LLC

, No. 715, 2016 WL 7014414 (Md. Ct. Spec. App. Nov. 30, 2016), Maryland's intermediate appellate court explained direct benefits estoppel as the court waded into a contract dispute between a commercial property owner and a design-build contractor.

Case background

This case involved the design and construction of the Bradshaw Office and Shop Complex (the project) and the relationships among three parties: BCC Properties LLC (the owner), WBCM LLC (the architect); and WBCM Construction Services LLC (the construction manager or CM). The Architect and CM operate under the brand Whitney, Bailey, Cox & Magnani LLC.

The owner had a written construction contract with the CM, consisting of AIA Document A131CMc-2003, "Standard Form of Agreement Between Owner and Construction Manager," and AIA Document A201-1997, "General Conditions of the Contract for Construction" (collectively, the contract). Notably, the owner did

not

have a written agreement with the architect — who was retained as the project architect by the CM in accordance with the owner-CM agreement.

Id.

at *1.

As the project progressed, the owner attempted to assert a claim against the architect by serving the latter with a demand for arbitration, purportedly pursuant to the contract. Claiming that it was not a party to the contract and that it never agreed to arbitrate disputes with the owner, the architect filed a petition in the local circuit court seeking to enjoin, terminate or stay arbitration with the owner.

The architect alleged that it is a "separate and distinct company from [the CM]" and that it never entered into an agreement with the owner where the former agreed to arbitrate its disputes with the latter.

Id.

at *3.

In response to the petition, the owner claimed that the architect

is

a party to the contract. The owner alleged that when it negotiated the contract, it did so with an individual who represented both the CM and architect. This individual was the contact person for both entities during the design and construction phases of the project.

Id.
at *3.

After an initial review of the parties' submissions, the circuit court asked them to file supplemental legal briefs on the issue of direct benefits estoppel. Specifically, the court wanted the parties to explain the direct benefit(s) that accrued to the architect under the contract (to which it was not a signatory).

Id.
at *3.

If the court were to find that such a direct benefit accrued to the architect, then the architect would be estopped, or barred, from arguing that it should not be compelled to arbitrate. Stated differently, a person should not be able to benefit from a contract on one hand, and avoid the detriments on the other.

Does direct benefits estoppel apply

The owner responded by pointing out how the architect directly benefited from the contract. The architect was compensated for its design work, the architect advertised the project design at issue on its website, and the subject claim at issue principally concerned the architect's design of the project. As the appeals court explained, the circuit court was persuaded by the owner's arguments:

"The [circuit] court stated that it is undisputed that [the architect] is not a signatory to the [c]ontract, but 'is named [in the contract] as the [a]rchitect and was engaged to perform design services for [the project].' The court framed the issue before it as 'whether [the architect], a non-signatory to the [c]ontract containing the provision for arbitration, can be compelled to participate in arbitration regarding a dispute arising out of the [c]ontract.'

"Applying the theory of equitable estoppel to reason that [the architect] is bound by the arbitration clause in the [c]ontract, the court answered that question in the affirmative."

Id.
at *3.

The circuit court denied the architect's petition and the architect filed an appeal (as of right) to the Court of Special Appeals of Maryland.

The appeals court commenced its analysis by noting that "[a]rbitration is consensual; a creature of contract."

Id.
at *4 (citation omitted). Next, the court looked at the terms of the contract. As the court explained, it must first "determine from the language of the agreement itself what a reasonable person in the position of the parties would have meant at the time it was effectuated."

Id.
at *4.

Restating the well-worn axiom, the court noted, “A party cannot be required to submit any dispute to arbitration that it has not agreed to submit.”

Id.

at *4 (citations omitted).

To make its determination, the court analyzed the following key terms and features of the written agreement between the owner and CM:

The contract is between the owner and CM.

The contract is signed by a partner of the owner and the president of the CM.

Under the contract, the CM was required to provide construction management services, hire all of the subcontractors and engage the architect.

The A131 document provides that the A131 document and materials incorporated therein “represent ... the entire and integrated agreement between the owner and the construction manager.” (This is known as a merger clause.)

The A201 document has a similar merger clause: “[T]he [c]ontract represents the entire and integrated agreement between the parties hereto and supersedes prior negotiations, representations or agreements, either written or oral.”

The A201 document provides that the contract “shall not be construed to create a contractual relationship of any kind (1) between the [a]rchitect and [c]ontractor ... [or] (3) between the [o]wner and [a]rchitect.”

While the contract designates arbitration as the parties’ dispute resolution mechanism, the A201 document specifically states: “No arbitration arising out of or relating to the [c]ontract shall include, by consolidation or joinder or in any other manner, the [a]rchitect, the [a]rchitect’s employees or consultants, except by written consent containing specific reference to the [a]greement and signed by the [a]rchitect, [o]wner, [c]ontractor and any other person or entity sought to be joined.”

Id.

at *2.

Contract language controls

After looking at the above clauses in light of existing legal authority in Maryland, the appeals court reversed the circuit court, finding that direct benefits estoppel did

not

apply and the architect was not required to arbitrate with the owner. As the appeals court explained:

“[H]ere [the architect] is neither a signatory to the [c]ontract nor the party seeking relief under the [c]ontract. Moreover, here the [c]ontract includes a provision expressly

excluding

[the architect], as the [a]rchitect, from any arbitration proceeding arising under the [c]ontract, absent written consent by [the architect], [the CM], and [the owner].

“Thus, the issue before us is whether a non-signatory to a contract that includes an arbitration clause

and

a clause excluding the non-signatory from arbitration nevertheless may be compelled to arbitrate by a signatory making claims against it, under the doctrine of direct benefits estoppel. We conclude that it may not.”

Id.

at *8.

In short, the appeals court held that the express language of the contract prevails over the equitable concept of direct benefits estoppel.

The takeaways

The moral of the story here is quite simple: Read the contract. The plain, unambiguous language of the parties’ agreement — assuming it was lawfully entered into — is going to trump principles of equity in the law.

In addition, now that you are a bit more familiar with direct benefits estoppel, you should know that different jurisdictions (

i.e.

, courts in different states) interpret and apply the concept differently. Here, we discussed the application in Maryland as a specific example. However, other states may have cases that are inconsistent with Maryland’s.

This is the second moral of the story: Consult an attorney to review your commercial contracts. Not only does contract review require a study of the express language of the agreement, but it also requires a close look at applicable laws for guidance as to how that language will be interpreted in a specific jurisdiction.

This is in the specific wheelhouse of construction lawyers, not plumbing contractors or engineers.