RENDERED: May 15, 1998; 2:00 p.m.
NOT TO BE PUBLISHED

NO. 97-CA-0049-MR

PINNACLE REALTY GROUP, INC.
and F. W. SCHNEIDER, JR. APPELLANTS

v. APPEAL FROM SHELBY CIRCUIT COURT
HONORABLE WILLIAM F. STEWART, JUDGE
CIVIL ACTION NO. 96-CI-000393

HI POINT APARTMENTS
PHASE III LTD. and
CLEAR CREEK PROPERTIES, INC. APPELLEES

OPINION
AFFIRMING IN PART - REVERSING IN PART

* * * * *

BEFORE: GUIDUGLI, KNOX and MILLER, Judges.

GUIDUGLI, JUDGE. Pinnacle Realty Group, Inc. (Pinnacle), and F. W. Schneider, Jr. (Schneider), the sole shareholder of Pinnacle, appeal from an order of the Shelby Circuit Court entered December 13, 1996, which denied their motion to stay proceedings pending arbitration. We affirm in part and reverse in part.

On October 17, 1994, Clear Creek Properties, Inc. (Clear Creek) entered into a contract with Pinnacle for the construction of four apartment buildings at the Hi Point Apartment complex. Hi Point Apartments Phase III Ltd. (Hi Point) entered into a similar contract with Pinnacle for the construction of three buildings at the same complex on October 2,

1995 (the 1995 contract). In addition to the 1995 contract, Schneider, Pinnacle and Hi Point entered into an undated agreement whereby the parties agreed that a "unique checking account" would be established to "pay vendors and subcontractors working on the Hi Point Phase III project[.]" Schneider also executed a guaranty where he personally undertook to guarantee the performance of Pinnacle pursuant to the terms of the 1995 contract.

Both contracts were the 1987 edition of the Standard Form of Agreement Between Owner and Contractor and both contracts incorporated the 1987 edition of the General Conditions of the Contract for Construction. Pursuant to Section 4.5.1 of the General Conditions, the parties agreed that all controversies or claims "arising out of or related to the Contract, or the breach thereof," would be resolved through arbitration.

On September 16, 1996, Clear Creek and Hi Point filed suit in the Shelby Circuit Court against Pinnacle and Schneider. The complaint contained allegations of breach of both contracts, misrepresentation of material facts, and breach of fiduciary duty by Pinnacle and Schneider. Paragraph 5 of the complaint alleges that the claims against Pinnacle and Schneider arise from the construction of the apartment buildings at the Hi Point complex.

Prior to being served with the appellees' complaint, Pinnacle filed a mechanic's lien on the Hi Point complex to secure payment of funds allegedly owed to Pinnacle for work performed at the Hi Point complex. The appellees responded by

amending the complaint to include an allegation that Pinnacle's mechanic's lien was void and as such constituted a slander of title, malicious prosecution, and abuse of process.

On October 21, 1996, Pinnacle filed a motion to dismiss and to stay proceedings. Pinnacle argued that the proceedings should be either dismissed or stayed pending arbitration of the claims. Pinnacle argued that the arbitration clauses contained in the contracts are enforceable under the Federal Arbitration Act (FAA). The trial court denied Pinnacle's motion without explanation and this appeal followed.

Initially, the appellees contend that this Court must affirm the trial court's order because Pinnacle took no steps to initiate arbitration under the terms of the contract. The appellees point out that at the time Pinnacle and Schneider moved to stay the proceedings there had been no action on their part to institute arbitration and argue that pursuant to the terms of the Federal Arbitration Act (FAA) Pinnacle is not entitled to a stay. Section 3 of the FAA provides:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 3. The default provision of § 3 has been construed by the federal courts to "refer to a party who, when requested, has refused to go to arbitration or who has refused to proceed with the hearing before the arbitrators once it has commenced." Kulukundis Shipping Co., S/A v. Amtorg Trading Corp., 126 F.2d 978, 989 (2nd Cir. 1942). The federal courts have also recognized that a party to a contract which contains an arbitration clause who elects to sue as opposed to arbitrate is himself in default as opposed to the defendant. Shanferoke Coal & Supply Corp. v. Westchester Service Corp., 70 F.2d 297, 299 (2nd Cir. 1934).

Kentucky has recognized that arbitration is contractual in nature and as such is capable of being waived. Valley Construction Co., Inc. v. Perry Host Management Co., Inc., Ky. App., 796 S.W.2d 365, 367 (1990). However, waiver will not be inferred lightly, and the mere filing of a pleading in a legal action will not act as a waiver of a contractual arbitration provision. Valley Construction, 796 S.W.2d at 367. Thus, we do not find Pinnacle to be in default by failing to request arbitration. "It was the plaintiff who declared the contract to be at an end; and with that the defendant was contented. If the plaintiff meant to proceed further and enforce a claim for damages, the initiative [to commence arbitration] rested on it[.]" Shanferoke Coal, 70 F.2d at 299.

We now address Pinnacle's claim that the trial court erred in refusing to grant its motion to stay. The standard of

review in the federal appellate court of a district court's refusal to stay a proceeding pending arbitration is de novo. See In Re Solomon Inc. Shareholder's Derivative Litigation 91 CIV.5500 (RRP), 68 F.3d 554, 557 (2nd Cir. 1995). We see no reason for not applying the same standard.

Under § 2 of the FAA, a written provision in a contract involving interstate commerce which provides that all disputes arising out of the contract are to be settled by arbitration is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The United States Supreme Court has ruled that the FAA pre-empts state law, thus state courts cannot use state statutes to invalidate agreements to arbitrate. Southland Corp. v. Keating, 465 U.S. 1, 15-16, 104 S.Ct. 852, 860-861, 79 L.Ed.2d 1, ___ (1984). Furthermore, the Kentucky Supreme Court has recognized that there is no public policy in Kentucky which would prevent enforcement of a private agreement to arbitrate pursuant to the FAA. Kodak Mining Co. v. Carrs Fork Corp., Ky., 669 S.W.2d 917, 921 (1984). See also, Fite & Warmath Construction Co., Inc. v. Mys Corp., Ky., 559 S.W.2d 729 (1977) (recognizing that FAA applies in state court where suit involves contract evidencing transaction in interstate commerce).

Pinnacle maintains that where the claims made in a complaint fall within the scope of the arbitration agreement the trial court is required to stay the proceedings pending arbitration. Pinnacle further argues that all of the issues

raised by the complaint arise out of or relate to the two contracts and are thus subject to the arbitration clauses. We begin by noting that any doubts concerning the scope of an arbitration issue are to be decided in favor of arbitration. Hill v. Hilliard, Ky. App., 945 S.W.2d 948, 951 (1996). See also, Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). We are to compel arbitration pursuant to a written arbitration clause unless we are able to find with absolute assurance that the arbitration clause cannot be interpreted in such a fashion as to cover the dispute. See S+L+H S.p.A. v. Miller-St. Nazianz, Inc., 988 F.2d 1518, 1524 (7th Cir. 1993; Kansas Gas & Electric Co. v. Westinghouse Electric Corp., 861 F.2d 420, 423 (4th Cir. 1988); Explo, Inc. v. Southern Natural Gas Co., 788 F.2d 1096, 1098 (5th Cir. 1986). As the appellees maintain that their claims fall outside the scope of the arbitration agreement, they bear the burden of proof. Hill, 945 S.W.2d at 950. We will examine each claim separately.

Count 1

In Count 1, the appellees allege that: (1) Pinnacle "breached the Phase II Agreement by failing to achieve substantial completion...in accordance with the terms of the Phase II Agreement"; (2) substantial portions of the work done by Pinnacle were not in compliance with applicable specifications; (3) Pinnacle diverted funds paid to it by Clear Creek to other obligations, failed to satisfy timely claims of project

subcontractors, and falsely represented to unpaid subcontractors that it had not received payment from Clear Creek; and (4) Pinnacle failed to satisfy claims of subcontractors, laborers, and vendors out of payments made by Clear Creek to Pinnacle. The appellees do not address Count 1 in their brief on appeal, and we agree with Pinnacle that the claims contained in Count 1 of the complaint clearly come within the scope of the arbitration clauses.

Counts 2 and 5

In Counts 2 and 5 of its complaint, the appellees claim that Schneider, acting individually and as Pinnacle's agent, gave Clear Creek an "Unpaid Subcontractor List" which he represented to be a complete and accurate list of all unsatisfied obligations relating to the project and falsely represented to Hi Point that it had paid its obligations with respect to the project. The appellees allege that Schneider acted fraudulently in maintaining that the list was complete and accurate, and further that they relied on the false statements and was damaged. On appeal, the appellees maintain that it is the allegedly fraudulent conduct of Schneider which forms the basis of its claim, and not the "tangential relationship to the contract."

The federal courts have recognized that a party will not be permitted to avoid compliance with a contractual agreement to arbitrate by framing a cause of action as a tort. See Sweet Dreams Unlimited, Inc. v. Dial-A-Matters International, Inc., 1 F.3d 639 (7th Cir. 1993); In Re Oil Spill by the "Amoco Cadiz,

659 F.2d 789, 794 (7th Cir. 1981). "Were the rule otherwise, a party could frustrate any agreement to arbitrate simply by the manner in which it framed its claims." "Amoco Cadiz", 659 F.2d at 794. In determining whether claims sounding in tort are arbitrable, we are to consider the relationship of the claim to the arbitration clause. Sweet Dreams, 1 F.3d at 643.

Like the claims of fraud and misrepresentation made in Sweet Dreams, Counts 2 and 5 raise neither questions of contract interpretation, performance, or validity. However, we believe that "they clearly have their genesis in the Agreement." Sweet Dreams, 1 F.3d at 643. We agree with Pinnacle that any statements made by Schneider pertaining to payments made to subcontractors, suppliers, and laborers arise out of the contracts.

We do not accept the appellees' argument that this interpretation of the arbitration clauses at issue is "so broad as to implicate nearly any event involving both Clear Creek and one or more appellants." Both federal and state law clearly evidence a strong policy in favor of arbitration. We cannot say with complete assurance in regard to Counts 2 and 5 that the arbitration clauses at issue are incapable of being interpreted in a manner which would not cover these claims. Therefore, arbitration of these issues is warranted.

Count 3

In Count 3, the appellees allege that Pinnacle breached the October 2, 1996 contract by: (1) failing to provide proper

manpower and equipment to ensure substantial completion as outlined by the terms of the agreement; (2) failed to achieve substantial completion as outlined by the terms of the contract; (3) failed to ensure that the work performed was in compliance with applicable specifications; and (4) diverting funds received from Clear Creek to other obligations and failed to timely satisfy claims of subcontractors with funds received from Hi Point. The appellees also allege that Schneider is personally liable for all damages described in Count 3 in accordance with the terms of the Guarantee.

As to the appellees' claims against Pinnacle in Count 3, they are essentially the same as those raised in Count 1. As such, they are clearly arbitrable for the reasons discussed supra.

As to the claims against Schneider individually, the appellees maintain that Schneider cannot reap the benefits of the arbitration agreement because he was not an individual party to the contracts. They rely on Sierra Rutile Limited v. Katz, 937 F.2d 743 (2nd Cir. 1991) for the proposition that a corporate officer, such as Schneider, of a company which is a party to an arbitration agreement is not considered to be a party to the arbitration agreement. Based on Sierra, Clear Creek maintains that Schneider is not entitled to a stay of litigation of the claims against him pending the outcome of arbitration between the appellees and Pinnacle.

If Schneider was trying to force arbitration of the claims against him pursuant to the terms of the contracts, we would be persuaded by Clear Creek's argument. However, the appellees overlook the fact that Schneider's liability to them pursuant to the terms of the guaranty agreement cannot be determined until it is found that Pinnacle has breached the terms of the contracts. "The litigation against [Schneider]...is an attempt by the plaintiffs to evade the agreed-upon resolution of their disputes in the arbitration forum by introducing the identical controversy in a judicial forum against a party who is ultimately liable for the arbitrating party's acts. [Schneider], as a party to litigation involving issues subject to an arbitration agreement, is entitled to a stay under section 3 of the FAA regardless of its status as a party to the arbitration agreement." Morrie Mages and Shirlee Mages Foundation v. Thrifty Corp., 916 F.2d 402, 407 (7th Cir. 1990).

Count 4

The allegations contained in Count 4 arise from the execution of the escrow agreement. The appellees allege that Pinnacle and Schneider neither opened the checking account or complied with the terms of the agreement. Count 4 also alleges that Schneider and Pinnacle failed to account for payments, disbursements, and incurred obligations with respect to the project, and that Schneider made false representations to Hi Point concerning Pinnacle's satisfaction of outstanding obligations.

With respect to the appellees' allegations against Pinnacle and Schneider regarding false representations and failure to account for payments and obligations incurred with respect to the project, those claims are subject to arbitration for the same reasons set forth in the above section dealing with Counts 2 and 5 of the complaint. The allegations concerning the purported escrow agreement are, however, a different matter.

Pinnacle contends that under Asplundh Tree Expert Co. v. Bates, 71 F.3d 592 (6th Cir. 1995), the escrow agreement acts as a modification of the earlier contract and is incorporated by reference thus making it subject to the contractual arbitration clause. We disagree. In Asplundh the second agreement specifically referenced the contract containing the arbitration clause and was deemed by the court to be part of the original contract. In this case, the escrow agreement makes no mention of the original contract and there is nothing in it which evidences an intent by the parties to incorporate the terms of the contract by reference. As such, any conflict arising from the escrow agreement is not subject to arbitration.

Counts 6 and 7

In Counts 6 and 7, which were contained in the amended complaint, the appellees contend that Pinnacle is not entitled to assert or recover by means of a mechanic's lien and that the filing of the lien constitutes slander of title, abuse of process, and malicious prosecution.

Again, we believe the appellees' claims in these areas fall under the scope of the arbitration clause. Again, we are not prepared to say with absolute certainty that the arbitration clause cannot be interpreted in such a fashion as to not cover the appellees' allegations.

In closing, we note that the arbitration clause contained in the two contracts was very broad. The appellees argue on appeal that to interpret the arbitration clause as we have done opens the door to a whole parade of troubles which would have to be settled by arbitration. In those cases, we would be able to say that the arbitration clause could not be interpreted in favor of arbitration. However, that is not the case before us. The contracts were entered into voluntarily by sophisticated and knowledgeable parties and the appellees have not persuaded us that their claims are not covered by the scope of the arbitration clauses. See Fite & Warmath, 559 S.W.2d at 735.

Having considered the parties' arguments on appeal, the decision of the Shelby Circuit Court is reversed except as to appellees' claims pertaining to the escrow agreement as raised in Count 4, and this matter is remanded to the Shelby Circuit Court for further proceedings in accordance with this opinion.

ALL CONCUR.

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