Chapter 04

Arbitration – A Major Form of ADR

As noted in a prior chapter, arbitration is one of the most important Alternative Dispute Resolution (ADR) techniques. Arbitration is often chosen as a method for settling disputes because it is faster, simpler, and less expensive than litigation (see Page 3 for cost comparison).

This chapter discusses the following:

4.01 Definition of Arbitration

Arbitration is a method whereby disputes are brought before a neutral third party (the arbitrator) who, after carefully reviewing all of the relevant information, issues a final decision in favor of one of the parties. Consumers, businesses, and government departments — even courts themselves — have successfully used arbitration programs to resolve disputes, and there is widespread satisfaction with the process. Arbitration offers parties a decisive legal outcome to their dispute without the expense and inconvenience of court proceedings and attorney fees.

4.02 Requiring Arbitration to Resolve Disputes

Generally, the decision to use arbitration as a means of settling any contract dispute is determined at an early stage in the contract process. Sometimes, the request for proposal itself will specify that any disputes will be settled through arbitration. Sometimes, the use of arbitration is agreed upon during negotiation of the contact.

While the agreement to arbitrate usually covers all potential issues, it can be limited to a specific purpose — a specific dispute or specific damages, for example. If it is limited, there is concern about the potential waiver of rights to seek the balance of relief in court and/or to split causes of action in complex situations partly outside the scope of a limited agreement.

In its broad, unrestricted form, the contract will have a provision such as the following:

"The parties agree to resolve by arbitration [and/or mediation or other ADR process] any and all disputes arising from, under or related to this agreement under the administration of and pursuant to the rules of such an ADR administrative body as the parties may agree and in default of such agreement, the American Arbitration Association and its [insert reference to appropriate rules] commercial rules of arbitration. The locale (location?) for such arbitration shall be [insert city]. Any award issued by an arbitration panel shall be binding and final and not subject to appeal for any reason. The parties shall each bear their own costs and expenses of arbitration and spilt equally the compensation and other related expenses of the arbitration unless the arbitrators, in the award, allocate such expenses differently."

If no provision is made in the contract for an alternate method of dispute resolution such as arbitration, the parties may agree while work is in progress, or even at the end of the project, to submit their differences to arbitration. Obviously, it is more difficult to reach agreement even on the questions involved in implementing an arbitration agreement in such circumstances.

In either case, all states require a written agreement to arbitrate signed by both parties before a court can enforce the award of the arbitration or, if necessary, even compel the parties to arbitrate.

4.03 Major Advantages/Disadvantages of Arbitration

On the plus side, arbitration offers several significant advantages because it:

Saves time and money in comparison to litigation. For example, in a major construction defect liability case with an exposure of approximately $6 million, an attorney estimated that litigation would take over four years at a cost of $600,000 to $1.2 million (exclusive of any award for damages). Conversely, the attorney estimated that arbitration would take less than 11 months at a cost of $300,000 to $500,000.

Is binding on both parties. Particularly if the agreement to arbitrate so states, arbitration can provide a final resolution of the issue (obviously, this can also be a weakness).

Provides a private solution. Arbitration is an agreement between two parties, not a process subject to public disclosure laws. It allows the parties to settle their disputes without the glare of the public press.

Does not establish precedent. Arbitration resolves an issue or issues in one construction case, but it does not establish precedence in a legal sense that might be applied to other cases in other situations.

Fits larger cases. Arbitration is particularly well suited to larger, more complex cases, but may be an expensive method of settling smaller disputes.

On the negative side, the disadvantages of arbitration are that it:

Depends heavily upon the skill of the arbitrator(s). Since the arbitrator is the ultimate finder of facts and makes judgements, his/her selection is crucial to the process.

Still involves the time and expense of lawyers. The arbitration process itself is sufficiently complicated so that the use of legal counsel, while not mandatory, is clearly the wisest course of action.

Provides a binding decision. For the losing party, this may not be a desirable outcome.

Is a formal process. By its nature, arbitration tends to prevent and/or reduce opportunities to reach compromises that save both sides time and money.

Still subject to delays. Arbitration can still result in time consuming delays. Especially, if there unanticipated issues such as venue, governing laws, selection of the arbitrator(s), and the like.

4.04 How the Arbitration Process Works

Often, contracts will specify that the arbitration process will be conducted in accordance with standard procedures as set forth by some administrative entity such as the American Arbitration Association (AAA).

Therefore, it is important for contractors and developers to know what the standard process includes so that they can make informed decisions about whether to specify the use of arbitration in contracts and/or to seek modifications in the process as a part of contract negotiations.

The general arbitration process is as follows:

Step 1

Arbitration is initiated with a demand. Generally, the rules of the administrative body (e.g., AAA) will dictate the form of the demand. It is important to note that state laws and any contract provisions may also apply. Absent a law requiring specificity in the demand, the best practice is to say as little as possible beyond that necessary to tell your story.

Typically, the demand states the nature of the dispute (e.g., breach of contract) and the relief sought (including monetary damages, costs and expenses of the action, including legal fees and arbitrators' expense and compensation.)

Ordinarily, the locale or venue stated in the agreement to arbitrate will control the venue and can be enforced. In the absence of a venue provision, the administrative body will be asked to resolve disputes over venue. The selection of venue, or locale, is a subject of some importance for several reasons. One, of course, is convenience in situations where the owner might, for example, be in California, the project in Washington, and the contractor from Colorado. Second, is the issue of which laws and statutes shall apply. And a third, not often as evident, is that if an organization such as the AAA is charged with selecting the arbitrator(s), its selections/recommendations will in part be governed by the locale in which the arbitration process will be conducted.

The demand must be sent to the administrative body with the appropriate fee, to the other side in the dispute and in some cases to some other people. For example, in some construction contracts the architect must receive notice of pendency of disputes.

The rules concerning architects and other "indispensable parties" are important in the construction industry because of the multitude of parties such as architects, engineers, and other professionals, not to mention sub-contractors, involved in the design and construction process. Often you cannot force the architect and the contractor into the same arbitration. Often you cannot force the contractor and all the subcontractors into the same case with the contractor and the owner. This can be altered by agreement or as specified in the contract or arbitration agreement.

Normally, the absence of a party otherwise indispensable is not a bar to arbitration, even though the result will be incomplete or exposes the participants to inconsistent results

Ordinarily, the rules in force on the day the arbitration demand is filed are the applicable rules. This is a critical issue of which to be aware. The rules, current and historical, of various administrative bodies are online for the most part and can easily be checked.

One note of caution is that the party initiating the demand should check the statute of limitations in the jurisdiction in which the arbitration will be brought. In some jurisdictions, there is no time within which arbitration must or can be commenced. More likely, most states have a statute of limitations and/or an arbitration agreements with time limits in them. These time limits limit the time in which claims can be brought.

Step 2

Answering statements. Not all rules require answering statements, and not all rules require that all claims that could be made be asserted in one demand or by way of answer. A claim can be asserted by counter claim. But asserting the claim without reservation ordinarily means that the one asserting the counter claim consents to the jurisdiction of the panel for all purposes. Normally, if a counter claim is filed, an administrative fee must be paid. Normally, if no answering statement is filed, the allegations of the demand are deemed denied.

Assuming joiner of indispensable parties is permitted, then cross claims would be as well.

Step 3

Arbitration selection. Normally, the selection of the arbitrator or arbitrators is specified in the arbitration agreement or in the rules used by the administrative body. This is an extremely important issue and a key example of where arbitration differs from, and is superior to, litigation. In arbitration, the parties have the ability to control who will be the ultimate fact finder and judge and how they will function. In litigation, the courts assign a judge (with some limited ability to make changes therein) and the method of operation is determined by the judge in accordance with procedures long prescribed by others.

Essentially, there are three alternatives for selection of the arbitrator(s):

- Single arbitrator. This could vary from a single person trusted by both sides for fairness and impartiality and specified by name in the contract to a renowned technician such as an engineer if the disputes are expected to be extremely technical in nature. Or, it could be simply a person assigned by the administrative body such as the AAA.

- Panel of the experts. For example, the language in the agreement to arbitrate might read:

  “The arbitration shall be conducted before a panel of three arbitrators. One arbitrator shall be a construction lawyer with experience in the litigation and arbitration of construction disputes for at least 15 years who shall serve as the Chairperson of the Panel. One arbitrator shall be an engineer with experience in the design of pre-cast structures. Another arbitrator shall be a person employed by, or

the principal of, a contracting firm with experience in the construction of structures similar to this project."

- Party-appointed model. There are at least two variations in this instance. In the first, each party (assuming there are only two parties) names an arbitrator and those two pick a third on who typically fills the position of chairperson. A second alternative is that each party names an arbitrator and selection of the third is left to the administrative provider such as the AAA.

Step 4

Pre-hearing conference. This conference is indispensable. Most rules provide that the arbitrator or arbitration panel can hold a pre-hearing conference, or that the administrative body can hold one without the panel members. It is best to hold one after the panel is established so it can begin to set the ground rules. Key subjects include:

- Schedule for hearing and disposition of entire case
- Discovery, whether any will be permitted and if so, under what conditions and limitations
- Interrogatories
- Requests to admit or otherwise establish uncontested fact
- Depositions (various states have rules on how depositions can be taken, as does the Federal Arbitration Act)
- Limits on time and witnesses
- Pre-hearing motions that dispose of all or part of the case
- Attempts to protect property subject to the arbitration
- Actions to preserve assets pending outcome of the proceeding
- Decision on whether parties want a one liner or a written, articulated decision. (May be controlled by statute or contract)
- Governing law ("This contract shall be governed by the law of the place where the project is located" or "This contract shall be governed by the law of the State of XYZ.")

Step 5

The Hearing(s). The arbitrator(s) will convene and conduct the hearing, dealing at the outset with issues such as the expected timing and number of sessions expected. Entire books have been written on the subject of arbitration hearings and all the issues involved therein. For the purposes of this paper, it is sufficient to note:

- Generally, legal counsel represents both parties, although that is not an absolute requirement.
- The form of the hearing generally follows the tradition examination of witnesses and introduction of exhibits.
- The process is somewhat less formal than in litigation. Indeed, in some cases the arbitrator, especially an inexperienced one, may allow an attorney to exploit the informality of the system.

Step 6

Rendering a Decision. In arbitration, the decision of the arbitrator(s) is final and binding on both parties. However, the parties do have some discretion in determining the form of the award, if such language is included the contract agreeing to arbitration in the first place.

The decision can take the form of a one-line sentence containing the decision itself with no explanation or reasons given therein. Or it can be more extended. In fact, it has not been the practice of the AAA to encourage their arbitrators to issue reasoned awards. Brief statements including the amounts awarded have been the norm in AAA construction arbitration. The explanation for this practice has been the AAA's desire to protect the awards from anticipated appeals to the courts if the logic and legal reasoning are set forth. If the parties wish to have a reasoned award for any reason, they must include a provision in their arbitration clause that requires one.

While the decision is binding and final, the subject of enforcement and appeals are a matter of applicable state law unless there is some basis for federal jurisdiction. One small exception is that the arbitrator can entertain a request to correct the award if an issue of clerical or simple math errors is present. However, even then, rules and statutes limit the jurisdiction of the panel once the award is entered.

4.05 Conclusion

Despite some problems, arbitration, especially when coupled with mediation (as described in the previous chapter), is a major Alternative Dispute Resolution technique that offers many benefits to litigation. It is a well-established process that has proved invaluable to many companies over the years.

4.06 Resources

Some of the key sources for additional information on mediation are:

- **National Arbitration Forum**
  P.O. Box 50191, Minneapolis, MN 55406-0191
  telephone at 952-516-6450 or 800-474-2377
  email at info@adrforum.com
  website at www.adrforum.com.

- **American Arbitration Association**
  Headquarters at 335 Madison Avenue, Floor 10, New York, NY 10017-4614;
  telephone at 212-716-5800 or 800-778-7879
  email at websitemail@adr.org.

- Mediation section at Neil Carmichael, Vice President
  200 South College Street, Suite 1800, Charlotte, NC 28202
  telephone at 704-347-6652
  email at CarmichaelN@adr.org.

- **Mediation Information and Resource Center**
  (http://www.mediate.com/).

- **American Bar Association**
  http://www.abanet.org/aztopics.html (Search: arbitration)

  See "ADR 101 – a Punch List of Concerns" by Raymond Garcia and MakingConstruction Arbitration Work – Starting at the Beginning" by Robert S. Peckar.

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1. An arbitrator is one who acts:
   a) As a neutral third party
   b) On behalf of the contractor
   c) On behalf of the owner
   d) As a representative of the courts
   e) None of the above

2. Generally, the decision to use an arbitrator comes:
   a) At the beginning of the contract process
   b) In the middle of the contract process
   c) At the end of the contract process
   d) At the time litigation is filed
   e) At any time during construction

3. Which of the following is a significant advantage of arbitration:
   a) Save time and money in comparison to litigation
   b) Provides a private solution
   c) The ruling is independent to each case and doesn't establish precedent
   d) Well suited for larger, more complex cases
   e) All of the above

4. Which of the following is a disadvantage of arbitration:
   a) A fair outcome depends heavily on the skill of the arbitrator
   b) May still require the use of legal counsel
   c) Is executed under a formal process with no exceptions
   d) The process is still subject to delays
   e) All of the above

5. Typically, the arbitration process begins with:

   a) Arbitration selection
   b) Pre-hearing conference
   c) Demand
   d) Answering statements
   e) The hearing

6. Which of the following is an alternative for selection of the arbitrator:
   a) Single person
   b) Panel of experts
   c) Party appointed model
   d) All of the above
   e) None of the above

7. Which of the following occurs during the pre-hearing conference:
   a) Schedule for hearing of the entire case
   b) Selection of the arbitrator
   c) Asserting of counter claims
   d) The demand is initiated
   e) None of the above

8. During the hearing, which of the following may occur:
   a) Both parties represented by legal counsel
   b) The form follows traditional court room examination of witnesses
   c) Exhibits may be introduced
   d) None of the above
   e) All of the above

9. Once the decision has been rendered by the arbitrator, a party may:
   a) Appeal to another arbitrator
   b) Do nothing - the decision is final
   c) File an appeal in court
   d) Do nothing if the verdict isn't favorable
   e) None of the above

10. Arbitration is most effective when coupled with:
    a) Negotiations
    b) **Mediation**
    c) Litigation
    d) Insurance
    e) None of the above