Evaluating Contractual Dispute Resolution Provisions: Arbitration

Over the past few months, this column has addressed the various steps in which construction contracts handle dispute resolution. As discussed, many contracts have a step-by-step approach to disputes. Often, the contractual process begins with the submission of claims to the engineer or architect for initial review. The process then moves to field-level negotiations or executive-level negotiations. Then the process frequently requires mediation as a prerequisite to litigation or arbitration. Because the initial determination, negotiation, and mediation are all non-binding, many construction contracts provide for either arbitration or litigation as the selected binding dispute method in the event a claim remains unresolved following the initial three processes.

Arbitration has long been a favored method of dispute resolution in the construction industry. Like litigation in a court, arbitration involves a contested case where a third-party determines a final outcome of a dispute. Unlike litigation in court, which can be very formal and rigid with respect to both the forum and the applicable rules, arbitration provides a more relaxed setting for dispute resolution. In arbitration, the rules of procedure and evidence often do not rigidly apply and there is not a judge or jury present to hear a case.

Arbitration often consists of one arbitrator, although large disputes frequently engage a panel of three arbitrators, sitting as the appointed decision-maker for the dispute. Most, if not all, preliminary matters involving the arbitrator take place on conference calls rather than in the actual presence of the arbitrator. The final hearing in which the evidence is presented to the arbitrator generally occurs in a conference room where the arbitrator listens to testimony and receives evidence that will determine the decision. The arbitrator's decision, referred to as an award, typically comes in writing to the parties a few weeks after the conclusion of the hearing. For these reasons, arbitration often provides a more comfortable setting for dispute resolution than a court of law.

When considering whether to include an arbitration clause in your contracts, attempting to predict the types of disputes that may arise can be a valuable exercise. If the contract has prohibitions against certain claims and waives parties rights for delay and consequential damages, then some of the most complex types of construction claims should not materialize. In that situation, the effort to educate a judge or sway a jury may be less daunting and an arbitration clause may not be necessary. If the contract incorporates a lengthy set of general conditions that layer various notice and claim provisions, then the likelihood that a jury would get lost in the weeds increases and an arbitration clause might provide a greater benefit.

In furtherance of the considerations above that focus on the types of disputes in helping to decide whether to arbitrate, understanding who the audience is in a dispute also plays a role. In court, the audience is a judge and a jury. While most seasoned judges have seen construction disputes because they are heavily litigated, most jurors have not. Even the judges who have seen construction disputes do not generally have an intimate understanding of construction law. The reality in most counties is that the judges spend the vast majority of their time on criminal and family law disputes. Even in counties where the civil and criminal judges do not overlap, the majority of cases are family law cases.

In arbitration, the audience is an arbitrator or an arbitration panel of the parties' choosing. Construction arbitration, as a process, typically uses lawyers who regularly practice construction law as the neutral decision makers. Often, that means the parties do not need to dedicate too much effort educating the decision maker about the law of the case or the particularities of the construction industry. Both of those efforts often have to occur in court. Also, in arbitration, the audience typically understands and enjoys the complexities of construction claims.

As stated previously, arbitration has been a favorite method of dispute resolution in the construction industry for some time. One reason for this status lies within the fact that almost all construction relationships rely on written contracts. Arbitration is a creature of contract. Without an agreement to arbitrate, the arbitrator has no legal authority. In other areas of business that do not rely on contracts, arbitration of disputes is not typically available. Building on this factor, the construction contract as an instrument assigns and shifts risks between the parties. Because the parties use energy to evaluate risk, the extension of that energy to anticipate and determine how potential disputes should be decided flows naturally.

The construction industry has been drawn to arbitration for the reasons outlined above. Additional motivation towards arbitration also comes from the general consensus that arbitration is faster and less expensive than litigation in court. Arbitration can deliver on these promises of being a faster and less expensive alternative. However, as with litigation, the arbitration process can be abused. Parties and lawyers who, in litigation, aggressively utilize the process to make the opposing side spend money in the hopes of wearing down their opponent can behave similarly in arbitration if unchecked. To prevent those tactics, the arbitrator needs to assert a strong position with the parties to limit discovery and motion practice so that the process does not become out of control.

In the past, some arbitrators were reluctant to engage in limiting the process. However, as parties are more frequently opting to litigate in court because the "faster and less expensive" arbitrations are not happening, more arbitrations are being conducted and administered with those goals in mind to preserve the benefit and favored status of arbitration. The burden of maintaining the integrity and benefits of arbitration does not need to fall solely on the arbitrator. The parties can mold the arbitration by writing limitations on discovery, the time for the process, and the prohibition against certain tactics into the arbitration clause or a supplemental arbitration agreement. Parties should keep these factors in mind when deciding if an arbitration clause should remain in a construction contract.

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