

Legal Update on Arbitration and Liquidated Damages

Last month, I addressed arbitration in the context of dispute resolution provisions in construction contracts. In continuation of that discussion, this column will discuss a recent court decision that addresses both the ability to limit the scope of an arbitrator's authority and the enforceability of liquidated damages clauses – both issues that arise frequently in contract negotiations and claim resolution.

In a case called *Belfiore Developers, LLP v. Sampieri*, the appellate court in Houston had an opportunity to examine the scope of an arbitration panel's authority, the grounds for modifying or vacating an arbitration award, and the enforceability of a nontraditional liquidated damages clause. The term nontraditional applies here because the liquidated damages clause at issue in the Belfiore contract was not based on a per diem as is ordinary in construction contracts. Rather, it was based on a percentage of the contract value in the event of default.

As stated in last month's column, most arbitration decisions are not appealable. Technically, under the Texas Arbitration Act, an award by a single arbitrator or an arbitration panel may be modified or corrected only if the award:

1. Contains an evident miscalculation (a math error),
2. It contains a clear mistake in the description of a person, company, or thing in the award (the award misidentifies the winning party), or
3. The arbitrators decided something

that was not properly part of the arbitration proceeding.

An award can be overturned only if the arbitrators:

1. Displayed evident partiality to one side,
2. Were corrupt,
3. Committed acts of misconduct,
4. Exceeded their powers,
5. Refused to hear evidence or grant a postponement of the hearing, or
6. Substantially prejudiced one side or another.

Over the years, courts looking at the Texas Arbitration Act in cases seeking to change or overturn an award have only allowed those results in the narrowest of circumstances. Generally, an arbitrator's decision is untouchable. However, the Belfiore case provides guidance for contractors and subcontractors that may want to push back against an arbitration clause. The Belfiore court recognized that the Texas Arbitration Act allows parties to define and limit an arbitration panel's powers. While not common, parties to construction contracts have occasionally put language into arbitration clauses limiting the arbitrators' authority. The enforceability and scope of these terms have not been certain. Under Belfiore, they now appear more certain.

The underlying contract between Belfiore Developers and Sampieri for the purchase of two condominium units contained an arbitration clause with language that stated the arbitrators' decision must be "based on and consistent with Texas law." After losing the arbitration and

appealing to the court, Sampieri argued that the provision limited the arbitrators' powers to make an award that was not consistent with Texas law. Sampieri asserted that the arbitrators had exceeded their authority because their enforcement of the liquidated damages clause was not consistent with Texas law; thus the award must be vacated as required by the Texas Arbitration Act. We'll discuss the particular liquidated damages claim shortly.

As for the arbitration award, the court stated that arbitrators get their power to decide disputes from contractual language. And, based on an earlier case, the Texas Arbitration Act allows parties to agree that an arbitrator may not issue an award that contains mistakes similar to those that would allow a trial court judgment to be overturned. While the court did not look at the particular language used in the Belfiore contract, it did reaffirm the principal that parties may limit an arbitrator's authority and may, therefore, subject an award to more review than would be allowed if the arbitration clause were silent as to the scope of authority.

Contractors or subcontractors seeking to resolve disputes through arbitration, but who may be hesitant with the assumed finality of arbitration awards, may want to consider adding language to an arbitration clause that binds the arbitrators to follow the law and, if errors in law are committed, then the award may be subject to judicial review. Of course, if the time and cost benefits addressed in my previous column are what drives parties to arbitration, allowing a judicial proceeding following the award will likely render the benefits of a quicker and less expensive proceeding meaningless.

Moving to the liquidated damages provision and the enforcement of said provisions, the Belfiore court had the opportunity to review a liquidated damages clause that called for forfeiture of 20 percent of the purchase price of each condominium unit under contract if the buyer failed to close as required. In Belfiore, the two units under contract by Sampieri were valued at \$2.48 million and \$2.7 million respectively. As such, the liquidated damages for failure to close the transaction were \$496,000 and \$540,000 each.

In examining the enforceability of these amounts, the court looked first to the liquidated damages clause, which provided for these amounts "not as a penalty, but because of the uncertainty and difficulty of ascertaining and measuring actual damages." Then court then applied controlling law on liquidated damages to the clause. The court first stated that liquidated damages is a measure of damages that parties



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event of a contract breach. A liquidated damages provision is unenforceable if it is actually a penalty for noncompliance rather than just compensation for loss. Further, the court stated a liquidated damages clause is enforceable if the harm caused by the breach is incapable or difficult of estimation, and the amount of liquidated damages is a reasonable forecast of just compensation.

In this case, because the testimony supported the enforcement of the liquidated damage based on the points stated above, the court determined that Belfiore could keep the liquidated damages it collected. For contractors, this case is a reminder that liquidated damaged clauses cannot be penalties for delay and that the amount assessed as liquidated damages must be based on a reasonable attempt at forecasting actual losses.

