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ADR in construction disputes

Most industry standard forms of agreement that address arbitration seem to be limited to providing the most basic submission agreement. Pre-dispute attention to the arbitration provisions of contracts can help avoid post-dispute arbitration shortcomings. The use of arbitration as an alternative to litigation has grown and expanded in many industries, including construction. Below are some recent developments in arbitration and several practical issues to be addressed regarding the drafting of arbitration provisions.

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DEVELOPMENTS IN ARBITRATION

There have been two relatively recent areas of development in arbitration practice of particular note: (1) the ascension of the Federal Arbitration Act's pre-emption of inconsistent state policies or procedures; and (2) the availability (or extent) of judicial review of awards for errors of law.

The FAA has been around for a long time (since 1925), but the scope of its pre-emption has recently been highlighted, as the U.S. Supreme Court has relied upon it in striking down various state procedures in several recent cases, including: rejecting class action arbitrations when not specifically agreed to (Stolt-Nielsen v. AnimalFeeds Int'l, 130 S.Ct. 1758 (2010)); restricting the rights of consumers to challenge allegedly unconscionable arbitration clauses in court (Rent-A-Center, West v. Jackson, 130 S.Ct. 2772 (2010); and striking down California's Discover Bank rule, which had found waivers of class action arbitration in alleged contracts of adhesion to be unconscionable under California law (AT&T Mobility v. Concepcion, 11 C.D.O.S. 4842). While their direct application to construction disputes seems remote, they serve as reminders of the need to address the issues of substantive law regarding procedures under which the arbitration is being conducted.

The prospects for judicial review of an award now largely depend on the statutory scheme the parties operate under. When seeking confirmation/vacatur under the FAA, the Supreme Court has determined that the FAA provides the exclusive grounds, thereby arguably eliminating the traditional "manifest disregard of law" standard. On the state side, the California Supreme Court has carved out a potentially rule-swallowing exception to the long-standing rule under Moncharsh v. Heily & Blase, 3 Cal.4th 1 (1992), that arbitration awards generally cannot be reviewed for errors of law or fact, by announcing that "parties may obtain judicial review of the merits by express agreement." The court found that the parties had expressly done so by using the following language: "The arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error."

FORM AGREEMENTS PROVIDING FOR ARBITRATION

The majority of construction industry standard forms of agreement (including AIA, ConsensusDocs, etc.) typically provide the most basic form of arbitration submission agreement: "any dispute arising out of or relating to this contract shall be resolved by arbitration administered under the rules of [ADR service provider]." The incorporated rules of the ADR service provider are usually self-executing and provide default choices for all aspects of the arbitration proceeding, from arbitrator appointment to hearing procedures and issuance of the award. Additionally, virtually all established rules provide the arbitrator(s) with flexibility to manage the process efficiently.

TAILOR THE PROCESS

It is preferable to incorporate by reference in the submission agreement a comprehensive set of arbitration procedures (such as AAA, JAMS, etc.), rather than referencing or incorporating a more bare-bones statutory scheme (e.g., California Arbitration Act, California Code of Civil Procedure §1280, et seq., or the FAA). Additionally, while incorporating an ADR service provider's arbitration procedures does not require utilizing that service to administer the arbitration itself, there can be real advantages to having a neutral administrator be able to promptly resolve any difficulties that might arise. Whichever base procedures are specified, they can be tailored to the parties' particular needs.

1. Selection of arbitrators. There are two principal issues to be considered here: (1) the number of arbitrators; and (2) arbitrator selection. For the purposes of this article, it is assumed that all arbitrators, including party-appointed arbitrators, will be neutral and independent.

Conventional wisdom holds that using three arbitrators instead of one reduces the risk of "outlier" decisions (which can be particularly objectionable when the award is not judicially reviewable), but this may also increase the cost of the hearings, and can cause scheduling delays. Preliminary scheduling delays can be minimized when utilizing a panel by delegating to

the chair of the panel the responsibility to hear and resolve pre-hearing discovery and scheduling disputes, unless the chair determines she needs specific input from the other panel members.

Selection of the particular arbitrator(s) is very important given the arbitrator's ex aequo et bono powers ("from equity and conscience"), and limited judicial review of arbitration awards. The proposed arbitrator's experience and background are important, and many have argued that the arbitrator's background, particularly for non-attorneys, can create an inherent bias in favor of a party with a similar background. However, the trend seems to be moving away from designating arbitrators to be chosen from a particular background (e.g., contractor), and toward selecting experienced construction attorneys.

Additionally, there is a widespread perception that arbitrators' potentially conflicting standards for "fairness" versus strict adherence to the letter of the contract or the law result in too many "split-the-baby" compromises, but there is no actual evidence of that. (Rand Institute for Civil Justice, Business-to-Business Arbitration in the United States, Perception of Corporate Counsel (2011)). One of the few studies that has tried to look at "consistency" in arbitration awards has found generally that, like litigation, arbitration results remain unpredictable, although the awards tend to be well-reasoned and free from arbitrator background bias. (Ossman, George, et al., "Consistency and Reliability of Construction Arbitration Decisions: Empirical Study," (April 2008) ASCE Journal of Management in Engineering).

Suffice it to say that the more input you have involving the selection of arbitrators, the better. Appointments of mutually acceptable, experienced arbitrator(s) by stipulation should always be explored. However, leaving arbitrator selection up to mutual agreement can be problematic, as the process of selecting arbitrators (including disqualification after disclosures) can be a fertile ground for delay and abuse. A third-party ADR service provider with a panel of experienced arbitrators and procedures in place for the appointment of arbitrators can more efficiently address these types of tactics than forcing a party to resort to the courts.

2. Delegation and limitations of authority granted to the arbitrator(s). There are at least four issues to be addressed here: (1) the scope of the dispute to be submitted ("all disputes arising under [except...]"); (2) the extent to which the arbitrator is directed to strictly follow the law (and/or the express terms of the contract); (3) the extent of judicial review for errors of law available; and (4) the procedures or rules governing the arbitration (both procedural (e.g., AAA or JAMS), as well as substantive (e.g., CAA vs. FAA)).

The issue of scope is relatively straightforward, and the vast majority of construction-related arbitration clauses appear to refer "all disputes arising under the contract" to arbitration. However, one of the most common challenges to awards has been, and will in all likelihood continue to be, the argument that the arbitrator "exceeded his powers," either by proceeding against a nonsignatory or by awarding an "improper" remedy (e.g., awarding attorneys fees when not recoverable under contract or by statute, etc.). Provisions to the effect that the arbitrator "shall render an award in accordance with the substantive law" of the appropriate jurisdiction or in accordance with the express terms of the contract may well influence the arbitrator's reasoning, but they are insufficient under California law to permit judicial review of the award on the grounds that the arbitrator exceeded his/her authority. (Gravillis v. Coldwell Banker Residential Brokerage, 182 Cal. App.4th 503 (2010)).

Similarly, expressly limiting an arbitrator's power to alter the terms of the parties' agreement did not unambiguously prevent the arbitrator from excusing a party's non-performance of a contractual condition precedent and awarding relief which appeared to be inconsistent with the terms of the contract. (Gueyffier v. Ann Summers, 43 Cal.4th 1179 (2008)).

The underlying franchise contract in Gueyffier included an explicit notice-and-cure provision as a condition precedent to finding a breach, and stated that this provision could not be modified or changed by the arbitrator. In his award, the arbitrator found that notice had not been provided, but excused claimant's lack of notice, explaining that notice would have been futile. The court held that excusing compliance with a condition precedent was not the same as modifying the contract, and therefore affirmed the award.

Limiting the arbitrator's authority to award certain categories or types of damages (e.g., consequential damages), however, appears to be judicially reviewable. Nevertheless, the California Supreme Court has stated that "in the absence of more restrictions in the arbitration agreement, the submission or the rules of arbitration, the remedy an arbitrator fashions does not exceed his or her powers if it bears a rational relationship to the underlying contract as interpreted, expressly or impliedly, by the arbitrator and to the breach of contract found, expressly or impliedly, by the arbitrator." (Advanced Micro Devices v. Intel, 9 Cal.4th 362 (1994)).

3. Limiting and managing discovery. While parties need a certain level of information in order to be able to make informed decisions regarding the resolution of their dispute, excessive discovery (and resulting delays) in arbitration were probably the chief complaints driving people away from it. Therefore, incorporating wholesale the discovery provisions of federal or state discovery schemes can often prove to be counterproductive. Providing the arbitrator with the authority to review and approve reasonably targeted exchanges of information or discovery, including experts, for good cause shown, usually maintains a reasonable balance between cost and preparedness. (See, e.g., JAMS Recommended Arbitration Discovery Protocols for Domestic, Commercial Cases (2010)).

CONCLUSION

Experienced construction counsel can add real value in tailored contract drafting of dispute resolution clauses and can help parties achieve more of the potential benefits of arbitration.

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