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| **The Arbitration of Construction Disputes: A Business Imperative**(and the importance of crafting the proper predispute arbitration clause) |
| **\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_****by James J. Damis**Harvard College (1958); Columbia Law School (1961);Member of the Oregon State Bar since 1962;Sole Practitioner, Portland;Administrator, Arbitration Service of Portland(www.arbserve.com)In spite of careful planning, skillful negotiation, and mediation, disputes in the construction industry will continue to occur and some will not settle. This article discusses the benefits of private arbitration for the resolution of construction disputes, the importance of predispute arbitration clauses, crafting appropriate clauses, and recommendations when an arbitration clause is incomplete or has been omitted. ("Private arbitration" means any arbitration conducted by agreement of the disputants and authorized by Oregon's version of the Uniform Arbitration Act (ORS 36.600-36.740) or the Federal Arbitration Act (9 USC Sections 1-14).)**Benefits of Arbitration.** The inclusion decades ago of an arbitration clause by the American Institute of Architects in its standard form construction agreement constituted the first major use by an important segment of American business of arbitration as a dispute resolution mechanism for commercial disputes. The construction industry quickly learned what the U.S. business community also is now discovering: compared with litigation, private arbitration offers speed, economy, efficiency, convenience, privacy and finality. Because construction disputes often involve complex factual and legal issues, arbitration also offers the most important benefit of all: the opportunity to select as the trier of fact and law a person who possesses high expertise in the subject area of the dispute and who is also intellectually able, conscientious, and impartial.**"But there's no appeal!"** Some litigators (nervous defenders of their courtroom turf) are quick to point out that an appellate court will not correct an arbitrator's fact-finding or an error at law. True enough. But remember that finality is itself of great practical benefit. Remember also: most courtroom fact-finding errors rarely rise to the level of reversible unreasonableness; judicial errors are not reversed unless prejudicial; appeals are expensive; most appeals do not succeed; and, successful appeals too often result in the dubious "new trial" reward of having to repeat the same expensive process. Litigators who would sacrifice the benefits of arbitration on the holy grail of appellate review fail to acknowledge a more pragmatic explanation of an adverse award: if you did not persuade an astute arbitrator (or, in large cases, a panel of three able people), perhaps you didn't deserve to win. The motto of the dispute resolver should be: "Do it once, do it right, and be done with it." In sum, the right to appeal is overrated.**A Golden Opportunity.** When the construction transaction is being negotiated, the client presents the basic deal points and relies upon the attorney to draft practical protections in the event of future breach or other downstream catastrophes. A properly crafted arbitration clause provides the greatest likelihood of obtaining your client's goals of protection and entitlements. The importance of an arbitration clause as a business planning tool (as both a shield and sword) cannot be over-emphasized. The failure by an attorney who drafts or reviews a construction agreement to incorporate an arbitration clause constitutes a serious oversight.      **The Rules of the Game.** Remember that private arbitration is a substitute for formal litigation's vast array of procedural rules. Therefore, to be effective, the arbitration clause must ensure an efficient procedural processing and the selection of an appropriate arbitrator, either by designating a specific arbitration service (and thereby incorporating the rules of that service) or by setting forth in the arbitration clause itself detailed rules on how the arbitration is to be initiated, the selection, qualifications, and compensation of the arbitrator, discovery, determining the date and site of the hearing, etc. If the arbitration clause merely requires dispute resolution by arbitration (and nothing more), or even if it goes on to state how the arbitrator is to be selected, but provides no procedural rules, downstream problems often occur because parties who are then at war must thereafter agree on the rules of the game. Arbitration clauses that do not ensure an efficient beginning to end processing will prove impractical if the other side later refuses to cooperate. Remember that one party to a dispute usually is satisfied with the status quo, and too often this reluctant party uses an incomplete or open-ended arbitration clause to continue to avoid the resolution of the dispute. Construction disputes governed by incomplete clauses will present continuing procedural problems and the difficulties encountered will be in direct proportion to the contentiousness of opposing counsel: the bigger the jerk, the greater the problem. Requiring arbitration "in accordance with the rules of" a designated arbitration organization is the most expedient way to avoid such problems.**Providing for the Selection of the Arbitrator.** In addition to providing for an efficient procedural processing, the arbitration clause also should ensure the selection of an experienced and able person to serve as arbitrator. *Quality is paramount.* If the predispute arbitration clause requires arbitration pursuant to the rules of a designated arbitration organization, a list of proposed arbitrators will be submitted to the disputants by the arbitration organization after an arbitration has been initiated. Although the parties then will have an opportunity to participate in the arbitrator selection process, the quality of the arbitrators being proposed is crucial. Therefore, in addition to reviewing the procedural rules of the arbitration service being proposed, the attorney should ask for a sample list of arbitrators. *You pick one; I pick one.* Arbitration clauses that do not designate an arbitration service sometimes require that each side select its own (non-neutral) arbitrator, with those two non-neutrals then selecting a third arbitrator. There are defects in this procedure. Selecting the third arbitrator can be time-consuming, and a stalemate will require an appointment request to a court and the parties must accept the judge's selection. Using three arbitrators, only one of whom is neutral, is an unnecessarily expensive and often distasteful arrangement. Moreover, such clauses rarely establish even minimum qualifications for the arbitrators and it is cumbersome to monitor any conflicts of interest or to conduct an appropriate challenge should a conflict arise. *Three-person panels.* The parties must also decide at what monetary level the dispute should be decided by a panel of three arbitrators rather than a sole arbitrator. Whether the figure should be $50,000 or $100,000 (for example) represents an attorney's assessment of when the additional expense and scheduling complications of a three-person panel is justified. *Preselection.* One method that eliminates any future selection process (and also to ensure an accelerated arbitration process) is to preselect and identify in the arbitration clause a list of arbitrators, named in order of preference, with the ultimate selection being based upon availability and absence of any conflicts of interest.      **The American Arbitration Association: Mitigating Its Defects.** Because the AIA contract designates the American Arbitration Association, construction lawyers are familiar with its procedures as well as its many shortcomings: AAA's administrative fees are high, its response time inexplicably slow, its procedural rules for construction arbitration are frustratingly silent on discovery and surprisingly unsophisticated, and (for Oregon) its nearest office is Seattle and its staff has no lawyers to discuss complicated or unusual procedural issues. AAA's nearest case-administration office is in Fresno. Nevertheless, in spite of AAA's expense and its procedural and administrative defects, an arbitration clause naming AAA is infinitely better than no clause at all. Moreover, for clients engaged in multi-state construction who desire a standard clause, AAA offers the advantage of providing service throughout the United States. If an AAA designation is used, some of AAA's procedural deficiencies can be overcome by adding additional language to the arbitration clause, as proposed in the attached Addendum to the AIA agreement.**Arbitration Service of Portland: A Better Alternative.** For Oregon construction attorneys and their clients, Arbitration Service of Portland (ASP) offers significant advantages to AAA. (See the attached ASP vs. AAA comparison sheet.) A review of ASP's attorney's file (free for the asking) reveals the following features:* High quality arbitrators, each with a minimum of ten years in practice, pre-screened for expertise in the subject area. (A sample list is included in ASP's attorney's file.)
* ASP's construction law panel includes construction lawyers (and, when requested by the parties), architects and engineers.
* Reasonable fees and costs. (In a typical two-party one-arbitrator dispute under $250,000, the filing fee is $700. The arbitrator receives his/her regular hourly rate, but not to exceed $495/hr.)
* Sophisticated procedural rules include:
	+ full discovery (pursuant to ORCP)
	+ 14-day pre-hearing statement of proof (to avoid a hearing by ambush)
	+ presumed admissibility of certain documents and affidavits
	+ provisional process and construction lien rights are preserved
	+ consolidation of related disputes
	+ default procedures against non-responding party

Because ASP is designated in preprinted business forms used throughout the state, ASP has established arbitrator panels in Salem, Eugene, Bend, Pendleton, Southern Oregon, and elsewhere. ASP administers more private arbitrations in Oregon than any other organization.**Crafting the Arbitration Clause.** Consider the following basic predispute arbitration clause for a construction contract, to which additional provisions can be added:***Arbitration Required/Mediation First Option.****Any dispute or claim that arises out of or that relates to this agreement, or to the interpretation or breach thereof, shall be resolved by arbitration in accordance with the then effective arbitration rules of Arbitration Service of Portland, Inc. or the American Arbitration Association, whichever organization is selected by the party who first initiates arbitration by filing a claim in accordance with the filing rules of the organization selected, and judgment upon the award rendered pursuant to such arbitration may be entered in any court having jurisdiction thereof. The owner, the contractor, and all subcontractors, material suppliers, engineers, architects, designers, construction lenders, bonding companies, and all other parties concerned with or involved in the performance of the contract are bound, each to the other, by this arbitration clause, provided such party has signed this contract, or has signed a contract that incorporates this contract by reference, or signs any other agreement to be bound by this arbitration clause. This arbitration clause shall not preclude any party from filing a statutory construction lien or from commencing suit to foreclose such lien, but the foreclosure suit shall be stayed until the rendering of the arbitration award, which award shall be binding in such foreclosure suit as to all matters determined in arbitration, and the lien may then be foreclosed to the extent permitted by law. The parties acknowledge that mediation usually helps parties to themselves settle their dispute. Therefore, any party may propose mediation whenever appropriate through one of the above named organizations or any other mediation process or mediator as the parties may agree upon.*Mediation is always the first alternative to consider when settlement negotiations falter. But, a dispute resolution clause should not require mediation as a legal condition precedent to arbitration or litigation, because it allows a defendant in bad faith to use the mediation process as a delay tactic. By its very nature, mediation is a settlement process that any party can terminate at any time for any reason (good or bad).**Attorney's Fee Clause.** If an attorney's fee provision is desired, the attorney's fee clause should specifically cover arbitration:***Attorney's Fees.****In the event suit or action is brought, or an arbitration proceeding is initiated, to enforce or interpret any of the provisions of this agreement, or that is based thereon, the prevailing party shall be entitled to reasonable attorney's fees in connection therewith. The determination of who is the prevailing party and the amount of reasonable attorney's fees to be paid to the prevailing party shall be decided by the arbitrator(s) (with respect to attorney's fees incurred prior to and during the arbitration proceedings) and by the court or courts, including any appellate court, in which such matter is tried, heard, or decided, including a court that hears a request to compel or enjoin arbitration or that hears any exceptions or objections to, or requests to modify or vacate, an arbitration award submitted to it for confirmation as a judgment (with respect to attorney's fees incurred in such proceedings).***Additional Provisions to Consider.** Customizing the arbitration clause for construction contracts will depend on such factors as the size, location, type and complexity of the construction project. Particularly when AAA has been designated, it is especially important to consider additional provisions, such as the following:* Requiring an arbitrator to be a construction law attorney with not less than ten years in practice.
* Providing that any three-person panel shall include (when appropriate) an arbitrator who is an architect or engineer (with a specific expertise, where appropriate).
* Specifying that the arbitration shall be decided by a sole arbitrator if the amount in controversy does not exceed a specific dollar amount, and a three-person panel for disputes exceeding that sum.
* Establishing a fair arbitrator compensation (to increase the likelihood of arbitrator acceptance).
* Designating the city in which the hearing shall be held.
* Permitting a party to apply to a court for provisional process (without waiving any arbitration rights) pending the initiation or completion of the arbitration.
* Establishing discovery procedures (for example, in accordance with ORCP).
* Requiring an exchange of the documents and a list of witnesses (including experts) 14 (or more) days prior to the hearing.

**Post-dispute Procedures to Correct an Inadequate or Nonexistent Arbitration Clause.** Unfortunately, attorneys are too often faced with construction disputes that arise out of agreements that do not contain an arbitration clause or clauses that are incomplete or unclear. The attorney's task in such instances is to propose to opposing counsel that the parties agree upon the most appropriate arbitration procedure possible. This discussion should take place while the parties are still attempting to settle the dispute and before the "final no" has been uttered. (When settlement discussions have broken off, hostilities likely are more intense and it therefore becomes more difficult to agree upon an efficient arbitration procedure.) There are several scenarios:* If the agreement did not contain an arbitration clause, propose to submit to arbitration under a specific arbitration service, preceded by mediation. If the other side balks at arbitration, consider offering to pay the entire cost of a mediation in exchange for an agreement to arbitrate if the mediation fails.
* If the arbitration clause lacks procedural rules, suggest submitting the dispute to an arbitration service to obtain convenience and certainty.
* If the arbitration clause requires resolution under the AAA rules, consider substituting an Arbitration Service of Portland arbitration so that both parties can benefit by lower administrative fees and more sophisticated procedural rules. (Parties to an agreement are always free to change their agreement.)

**Conclusion.** The benefits of arbitration for the resolution of construction disputes are far greater than the litigative alternative. The construction lawyer should protect the client at the outset by crafting a predispute arbitration clause that will automatically ensure the resolution of any future dispute efficiently, fairly, and inexpensively. Arbitration clauses should also be utilized whenever appropriate in other agreements involving the construction industry, including partnership, joint venture, and shareholder agreements; agreements with consultants; employment agreements; loan agreements.**ADDENDUM TO AIA CONSTRUCTION CONTRACT****(To supplement the arbitration clause)**The parties hereby amend and supplement paragraph no. \_\_\_\_\_\_\_ (Arbitration) by adding the following provisions:The arbitration required hereunder shall be conducted in accordance with the then effective arbitration rules of Arbitration Service of Portland, Inc. or the Construction Industry Arbitration Rules of the American Arbitration Association, whichever organization is selected by the party who first initiates arbitration by filing a claim in accordance with the filing rules of the organization selected.If the amount in controversy is $\_\_\_\_\_\_\_ or less, the dispute shall be decided by a sole arbitrator, and if the amount exceeds $\_\_\_\_\_\_\_ the dispute shall be decided by a panel of three arbitrators unless all parties to the dispute agree to use a sole arbitrator.An arbitrator shall be an attorney who has practiced law for not less than ten years and who has expertise in construction law.Each party shall be entitled to discovery as to any other party, which discovery shall be conducted in accordance with Oregon Rules of Civil Procedure, except that motions relating to discovery shall be decided by the (chief) arbitrator.The hearing shall take place in the city (metropolitan area) of \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.If the procedural rules governing the arbitration do not require a prehearing exchange between the parties of a list of documents and witnesses intended to be presented at the hearing, each party shall deliver to the other party/parties not less than 14 days prior to the hearing a list of the names, addresses, and day-time telephone numbers of the proposed witnesses and a list of the proposed documents that the party intends to use at the hearing and shall promptly deliver a copy of any listed document to a party who requests it. |