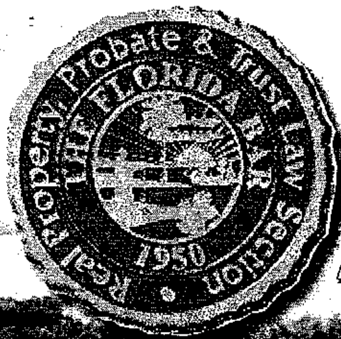

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Arbitration Clauses In Construction Contracts: Not A One-Size-Fits-All Solution

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The common wisdom is that arbitration provides a swift, private and cost-effective path to dispute resolution. Mindful of this widely held view, some construction attorneys overlook the possibility that their clients might be better served by civil litigation. As a result, many construction companies have learned the hard way that arbitration does not always deliver the promised benefits. Too often, the arbitration process turns out to be more costly and time consuming than anticipated. Other times, the process works "too well," with an adverse result that cannot be appealed. Ultimately, like most things, arbitration is not a one-size-fits-all proposition. This article provides a practical guide for attorneys and their clients to help them determine whether arbitration is the best option. For clients who can benefit from arbitration, this article examines how to maximize the benefits and minimize the risks by selecting a specific arbitration organization and using a customized arbitration clause.

The Benefits and Risks of Arbitration

The often-cited benefits of arbitration include speedy resolution, cost savings, confidentiality, limited discovery, and "expert" panelists. Certainly, arbitration can deliver these benefits. The real issues are the extent of the benefits provided and the risks that come with those benefits. These issues are not unique to construction contracts. However, many construction companies regularly execute substantial contracts in which virtually every detail has been heavily negotiated. Yet, because of the perceived universal benefit of arbitration, little thought has been given to the arbitration clause.

Speed and Cost Containment

We begin our analysis with the promise of speedy resolution and the reality that construction clients may face. Many arbitration clauses hit the brakes on the process before the arbitration even begins. Arbitration clauses can require the parties to engage in informal settlement talks and formal mediation before even initiating arbitration. Once arbitration is underway, the limited availability of motion practice can impede a party's ability to quickly dispense with dubious claims. Next, substantial discovery, including electronic discovery and depositions, may be part of the arbitration process, particularly in complex or high-dollar value disputes, which can further slow the process.

Once the parties have made their way to a final arbitration hearing, clauses which require the arbitration to occur in a remote location can make the process of coordinating a final hearing a daunting task. In addition, some arbitration clauses actually limit the number of days in a row that a final hearing can be conducted. Imagine your client's reaction to the prospect of being required to arbitrate in a distant location and having to coordinate multiple trips to complete your final hearing.

The cost of arbitration often goes hand-in-hand with the speed of arbitration. Even when an arbitration is not bogged down with pre-arbitration conferences and time-consuming discovery, cost considerations can come into play. Filing and administrative fees, particularly for large disputes, can quickly exceed $10,000. Many clients are in for a rude awakening when they are informed that the filing fee alone is $7,500 or more.

The fees paid to the arbitrator, or panel of arbitrators, are an even more significant cost driver. It seems simplistic to observe that judges and juries are free to the litigant. However, when the parties find themselves paying a panel of arbitrators over $100,000 they may become nostalgic for the days of a "free" judge and jury.

Finally, the logistical costs associated with out-of-state travel, rental of hearing facilities, and rental of audio visual equipment, much of which is built into state and federal courtrooms, also add to the arbitration price tag.

To be fair, not all of these schedule-stretching and cost-escalating factors will be present in every arbitration. Indeed, many arbitrations, particularly for smaller disputes, will face few of these challenges. Even an arbitration subject to numerous factors, which increase the cost and slow the progress of the arbitration, may still end up being less costly and faster than civil litigation. In addition, an arbitrator can provide a "date certain" for the final hearing, which is a significant advantage over the uncertainty of a lengthy trial period. Accordingly, with regard to speed and cost, even if arbitration does not always deliver to the degree clients anticipate, it is often still an improvement over civil litigation.

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Confidentiality

For some clients, keeping their sensitive information out of the public realm of civil litigation is paramount. As we move into the world of fully electronic filings, and searchable court dockets and documents, companies with an interest in privacy have a stronger motivation than ever to stay out of court. Put simply, we are fast approaching a world in which anyone, anywhere, can access almost anything filed in state or federal court. Accordingly, a private arbitration may be the last refuge for clients seeking to avoid a public airing of their dirty laundry.

Expert Panelist

Less clear are the benefits of having an "expert" resolve your dispute. The benefits of having a construction attorney, or a non-attorney construction professional resolve your client's dispute can be hard to measure. Is a construction expert really more likely to see the wisdom of your client's position than a jury? Is your opposition's position really so ill-conceived that the expert will not see some wisdom in their position? These are not easy questions to answer particularly at the time of contract formation when the precise contours of a future dispute are unknown. You may select your arbitrator once a dispute arises, but the decision to arbitrate is made when the contract is signed.

In theory, a party with a "technical" claim or defense may prefer the even-handed analysis of a knowledgeable subject matter expert who will not have to be educated during the trial like a lay juror. By contrast, a party with a good story may relish the opportunity to charm a jury panel. But here again, it is unlikely that you will know in which camp your client will fall at the time of contract formation.

Finality – Be Careful What You Wish For

For many clients, the real risk is that arbitration delivers too well on the promise of finality. Florida's Arbitration Code[1] provides a finite and extremely limited list of grounds to vacate an arbitration award. This list includes fraud, corruption or "evident partiality" of the arbitrator. In addition, an arbitration award may be vacated if a party's procedural rights have been violated by an arbitrator exceeding his or her powers, refusing to postpone a hearing despite good cause or refusing to hear material evidence.[2]

Needless to say, all of the grounds set forth in the statute and summarized above are extraordinarily rare. Even the most ardent conspiracy theorist would be hard pressed to identify corruption or fraud in the conduct of most arbitrators. Similarly, rare is an arbitration panel that exceeds its authority or otherwise violates the procedural rights of a party.

Notably absent from this list is anything resembling typical grounds for appellate review of a trial court's decision. Errors of law are not grounds to vacate an arbitration award in Florida or under the Federal Arbitration Act.[3] A lack of substantial competent evidence similarly is not grounds to vacate. Manifest disregard of the law is a common law doctrine often cited as an additional basis to vacate an arbitration award in other jurisdictions.[4] However, that doctrine has been rejected by various jurisdictions, including Florida, which have revised their arbitration codes and failed to codify the doctrine.[5]

For clients, the "right" result is always the one that favors their position. Clients hit with an adverse ruling often find it extremely difficult to accept that arbitration provides them with only one bite at the apple. The sting of arbitration finality can be particularly harsh when a client was denied full discovery. As will be addressed later in this article, typical arbitration rules either expressly limit discovery or provide the arbitrator with the discretion to greatly curtail discovery.

For clients who fear public disclosure, disruption and intrusive discovery, these limitations are significant benefits. Clients with millions of dollars on the line and a sincere belief that they will prevail if only the truth can be uncovered with an appropriate investment of time and money, may take a very different view.

So, Is Arbitration Right For My Client?

Every client is unique, and generalizations can only be useful to a point. However, answering the following questions is a good place to start:

- What size company is my client?
- What types of disputes does my client typically litigate?
- What considerations are most important to my client?

As a rule, larger companies may stand to reap the greatest benefits from arbitration. The privacy of arbitration can be an important consideration for companies that have invested significant resources in their public images. Larger companies also tend to be involved in a greater volume of litigation, and therefore they stand to benefit the most from the cost saving aspects of arbitration. Finally, larger companies typically have the resources to absorb any "bad" decisions rendered and can stomach the harsh reality of arbitration finality.

With regard to the types of disputes a client anticipates, another general rule is that companies with numerous smaller disputes can benefit most from arbitration. The speed and cost savings benefits may be significant in disputes with less than $100,000 at issue, particularly if the process is not bogged down with mandatory disclosures and significant discovery.

There is no doubt that some larger disputes will be resolved more quickly and inexpensively through arbitration as well. However, as the size of the dispute grows, both on an objective scale, and relative to the size of a client's company, the risk of an adverse ruling becomes a significant consideration. A small to mid-size construction company engaged in "bet the company" litigation may find the speed, discovery limitations, and finality of arbitration to be highly undesirable.

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Of course, the overriding consideration is what is most important to your client. Your client may be a small company that puts a premium on privacy, or a huge company that chafes at the discovery restrictions imposed by arbitration. Ultimately, the key is to ensure that the client understands the benefits and risks of arbitration and the practical realities that will flow from arbitration clauses. Predicting the future is a tricky business and anticipating the twists and turns of a future dispute is difficult at best. However, on balance, an informed decision will maximize the likelihood that your client ends up with an acceptable process, even if the outcome is adverse.

AAA, CPR or JAMS?

Deciding that your client wants to include an arbitration clause in its construction contracts (or is at least willing to sign contracts that contain arbitration agreements) is not the end of the analysis. The same considerations that drove your client's decision to arbitrate will impact the selection of an arbitration organization and ultimately the consideration of custom arbitration clauses. As in most transactions, one size may not fit all.

"Ultimately, the key is to ensure that the client understands the benefits and risks of arbitration and the practical realities that will flow from arbitration clauses."

The three most widely used arbitration organizations are the America Arbitration Association ("AAA"), the International Institute for Conflict Prevention & Resolution ("CPR"), and Judicial Arbitration and Mediation Services ("JAMS"). The rules and fee structures of these organizations vary significantly. Those rules and fee structures may align with your client's interests or run contrary to them. Accordingly, identifying an arbitration organization well-suited to your client's needs and including that organization and its rules in your arbitration clause is a critical first step in the process. It is worth noting that parties also have the option of arbitrating with no governing organization at all. The risks and benefits of a completely ungoverned process are beyond the scope of this article.

Once again, cost is an important factor. The different fee structures of AAA, CPR, and JAMS can result in huge cost differentials. All three organizations charge a filing fee and a separate administrative fee. AAA provides a sliding scale for both filing and administrative fees, which start at under $1,000 each. Those fees "slide" up to $7,000 (each) for multimillion dollar claims. CPR has a set filing fee of $1,750 and an administration fee of $8,250 for claims up to $5 million. JAMS has fixed filing fees of $1,200 for two party disputes and $2,000 for multiparty arbitrations. JAMS administration fees are tied to the professional fees of the arbitrators and each party will be charged a fee equal to 12% of the "professional" fees. This means that the fees are driven by the length of the final hearing versus the amount at issue.

The bottom line: CPR is not a good choice for smaller claims. The large upfront administration fee is a real problem. However, the relatively low fixed filing fee means that CPR may be cost competitive for larger disputes. By contrast, AAA's sliding scale means that it potentially offers the most cost-effective option for very small disputes. However, as the value of the claims increase and the hearing times lengthen, the price differential between AAA and JAMS can be minimal. Because JAMS links administration fees to professional fees, an apples-to-apples comparison is impossible.

Another cost-related issue is the number of arbitrators that will hear a dispute. JAMS' rules call for one arbitrator on residential construction disputes and other disputes with an aggregate claim value of under $2 million. For all other disputes, a three-arbitrator panel will be used. Under its Construction Industry Rules, AAA has discretion to appoint a three-arbitrator panel to any dispute. In addition, in any dispute with a single claim exceeding $1 million, a three-arbitrator panel will be used. Finally, CPR calls for three arbitrators in all circumstances. Importantly, all three organizations allow the parties to agree to have any dispute decided by a single arbitrator.

The bottom line: CPR's across-the-board requirement of three arbitrators again makes it a poor choice for the cost conscious, but a good option for those who want a thorough examination of the evidence in a high-value dispute with a prompt decision deadline. AAA and CPR have both tried to strike a balance by allowing a single arbitrator to resolve what they define as "smaller" disputes.

Another consideration impacting both cost and speed is the availability of expedited proceedings. All three organizations offer some form of expedited process. CPR offers a process with compressed timelines, but it still requires three arbitrators and significant discovery. AAA has an aggressive expedited procedure, which virtually eliminates discovery, compresses timelines, and mandates that all final hearings will be completed in one day. However, this procedure only applies to disputes where no claim exceeds $100,000. Finally, JAMS offers a procedure that eliminates depositions, but still mandates a full exchange of documents and electronically stored information ("ESI"). This process also involves a compressed timeline and reduced fees.

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The bottom line: AAA's expedited proceedings option is potentially a huge cost saver for clients with smaller disputes. For clients whose disputes tend to exceed $100,000, CPR and JAMS have options which may offer some cost savings, but the savings are tempered by the limited degree to which the proceedings are truly "simplified."

Finally, let's look at how these organizations approach discovery. CPR has the most open-ended rules, which allow such discovery as the tribunal determines to be "appropriate." JAMS mandates fairly broad discovery, including: (i) an initial exchange of all "relevant" documents *including ESI*, (ii) a duty to update your production as necessary, and (iii) two depositions of opposition witnesses, minimum. By contrast, AAA requires a voluntary production of documents on which the party "intends to rely" and depositions are *not* permitted unless the dispute is large or complex, and even then, only in "exceptional" circumstances.

The bottom line: AAA's discovery limits are highly desirable for clients who fear corporate disruption and disclosure, and may please clients who seek speed and cost containment. Clients who favor a more fulsome discovery process will be more at home with the relatively broad discovery limits of JAMS.

Arbitration Clauses That Meet Your Clients' Needs

Customized arbitration clauses are the final piece of the puzzle. Subject to very few restrictions, such as unconscionability, arbitration clauses are almost infinitely customizable.[6]

Speed and Cost Containment

For some clients, the promise of speed and cost containment is paramount. While it is true that not everything fast is inexpensive, the two often go hand in hand. For these clients, consider arbitration clauses that include the following:

- strict limitations on the time frames for discovery and completion of a final hearing;
- limitations on the nature of permissible discovery, including clauses prohibiting depositions;
- a requirement that the arbitrator issue a final ruling within a specified period of time; and
- a requirement that all proceedings be handled by a single arbitrator.

Limiting Discovery, Disclosure and Disruption

For other clients, the draw of arbitration is the confidentiality of the proceeding, and the limits on discovery and corporate disruption. For these clients, consider arbitration clauses which include:

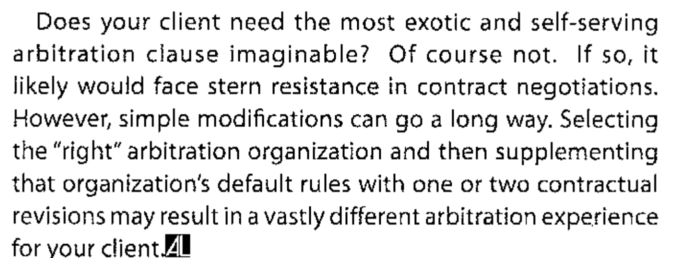
- provisions limiting or completely barring depositions;
- agreements that internal memos, email or other categories of company documents are considered confidential and not subject to discovery;
- restrictions on "e-discovery" and exchange of ESI; and
- a mandatory venue clause placing the final hearing at a location close to the client's headquarters or the job site.

Getting it "Right"

For clients who believe the truth is on their side and no stone should be left unturned, completely different clauses must be considered. These clients should consider arbitration clauses which:

- expressly entitle parties to take depositions and serve written discovery requests;
- provide for mandatory early exchange of all relevant ESI, including emails and project documents;
- allow the parties to take arbitration "appeals" through the internal appeals processes provided by arbitration organizations; and
- mandate a three-arbitrator panel for all arbitrations regardless of size.

While these clauses provide a good starting point, they are just the tip of the iceberg. Your client's specific goals and needs, and of course the willingness of the other party to agree, are the only real restrictions. The most important thing to remember is that a form arbitration clause is very likely not the best way to meet your client's needs. Fortunately, even after a dispute arises, the parties can agree to modify the standard rules and procedures.



Does your client need the most exotic and self-serving arbitration clause imaginable? Of course not. If so, it likely would face stern resistance in contract negotiations. However, simple modifications can go a long way. Selecting the "right" arbitration organization and then supplementing that organization's default rules with one or two contractual revisions may result in a vastly different arbitration experience for your client. AL

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Endnotes

1 Fla. Stat. § 682, et seq.

2 §682.13 Fla. Stat. (2017).

3 9 U.S.C. §10 (2017).

4 *See e.g. Wachovia Securities LLC v. Vogel*, 918 S. 2d 1004 (Fla. 2d DCA 2006).

5 Fla. Stat. § 682.013 (2017) (establishing effective date of July 1, 2013 for revised Florida Code).

6 Fla. Stat. § 607.1801; *Murphy v. Courtesy Ford, L.L.C.*, 944 So. 2d 1131 (Fla. 3d DCA 2006) (arbitration clause must be procedurally and substantively unconscionable to be unenforceable).