

REEVALUATING ARBITRATION AS A WAY TO RESOLVE A CONSTRUCTION DISPUTE

By: David L Kelly
Partner, Denton & Keuler LLP
555 Jefferson St, Suite 301
Paducah, KY 42001
dkelly@dklaw.com

Over the past several decades, parties to construction contracts have reflexively agreed to mandatory arbitration provisions as a way of resolving construction disputes. The prevailing view of the industry points to an inefficient, costly and time consuming court system as the primary benefit of arbitration over traditional litigation. In my assessment, this view is partially correct. The court system is in fact an inefficient and oftentimes costly and time consuming institution. On the other hand, arbitration certainly has its disadvantages and should not be viewed as the panacea for all ills associated with traditional litigation. That is not to say it should be scrapped and never considered as way to resolve a dispute. Far from it! However, contractors (as well as owners) should always be mindful of its limitations and in some cases, its detriment as an effective process to resolve a dispute. The following contains a brief summary of many misconceptions regarding arbitration that should always be considered before agreeing to it as a meaningful way to resolve a construction dispute.

A. Arbitration is not always a cheap and efficient way to resolve a dispute.

To refresh, arbitration is a binding process by which the parties agree to bypass the court system and hire a private arbitrator who acts as the judge and the jury on all issues applicable to the dispute. To initiate arbitration, a party files what is referred to as an “arbitration demand” with an arbitration service which service is typically agreed to by the parties in the contract. For example, the American Arbitration Association (“AAA”) is such a service that has become prevalent in construction contracts. AAA has its own set of rules which then govern the arbitration process rather than the formal rules that govern the court system.

It is not cheap to initiate arbitration with AAA. They charge a filing fee plus a “case service fee” based upon the amount in controversy. For example, for disputes that involve \$150,000 to \$300,000 in controversy, the party initiating the arbitration must pay a \$2,750 filing fee plus a “case service fee” of \$1,250 (\$4,000 total) just to get started. For disputes that involve \$300,000 to \$500,000 in controversy, AAA charges a \$4,250 filing fee plus a \$1,750 case service fee (\$6,000 total). This does not include the fees that are then charged by the arbitrator who is eventually chosen by the parties. The arbitrator charges an additional fee that is typically an hourly rate. The arbitrator is usually an attorney (though it is not required) with experience in construction legal matters. The arbitrator’s fees are usually required to be paid up front and depending on the complexity of the matter, can cost tens of thousands of dollars. They are usually split evenly between the parties. Of course, all these fees are in addition to whatever attorney fees each party will incur on their own in pursuing or defending the arbitration.

Therefore, it is not unusual for a party to incur thousands of dollars just to get the process of arbitration started.

A party who believes it has already been damaged enough by the other side may very well find it unsettling to be told that it must now pay thousands of more dollars just to get the process of arbitration initiated. By way of comparison, it costs about \$150 to file a civil lawsuit. Welcome to the world of arbitration!

B. Different Procedural and Evidentiary Rules Apply.

Arbitrations are designed so that they are more informal than civil lawsuits. They are typically not governed by the formal rules of evidence or the rules of civil procedure because parties have historically viewed such rules as cumbersome and an accomplice to the court system's inefficiency. On the other hand, there is a reason the rules of evidence as well as certain procedural rules were developed in the first place i.e., to insure that the trier of fact hears only relevant and material evidence in a setting that is fair and impartial to all parties.

Keep in mind that discovery in arbitration is more oftentimes than not, severely limited compared to discovery rights in civil litigation. This could have the effect of precluding a party from being able to effectively prepare for the arbitration, oftentimes not knowing what any witnesses will say until the arbitration hearing, leaving them little ammunition to combat what could very well be a lie, or a misconstruction of the evidence. Yes, discovery in a civil case can oftentimes be excruciatingly expensive. On the other hand, it may very well be money well spent if it serves to prove your case and/or permits you to prove that the other side's case has more holes than Swiss cheese.

C. Limited Appeal Rights Exist in Arbitration

There are limited rights to appeal the decision of an arbitrator. For the most part, it is the position of the courts that if the parties agree to binding arbitration as the mechanism to resolve their dispute, then they should be stuck with the arbitrator's decision. Therefore, unless a party can demonstrate that fraud was involved (which is almost impossible to do) the arbitration award will not be vacated even if you can demonstrate that it was incorrect as a matter of law, or that the arbitrator misapplied the facts, or even committed a mistake in applying the facts or the law. For the most part, the party who finds themselves on the wrong side of the arbitration award will not find any relief in the court system to overturn or vacate an arbitrator's decision.

Without any basis to review an arbitrator's decision, it is often viewed that the arbitrator is free to render a decision he or she believes fair, but may not be correct or justified under the facts or law. This oftentimes leads to the result of "splitting the baby." In contrast, parties in civil suits have the absolute right to appeal to an appellate court and if they can demonstrate error, will be successful in overturning an incorrect verdict.

C. Joinder Issues

A party may only be compelled to arbitrate if it has agreed to do so by contract. This becomes problematic when a contractor has a dispute with two or more parties but only has a contract with one of them. For example, a typical dispute often involves the design professional, the contractor, one or more subs, as well as the owner. A contractor may be compelled to arbitrate the dispute with the owner (with whom it has a contract) and left to litigate in a separate action, its issues with the other parties whom it has no contract and without the ability to compel or join in the arbitration. This obviously diminishes the benefits of the mandatory arbitration and could prove a detriment to the contractor forced to fight two fronts at the same time.

D. Conclusion

The above is not designed to argue that arbitration is never an effective tool or that civil litigation should always be preferred to resolve a construction dispute. It is obviously beyond the scope of this article to analyze the pros and cons of arbitration versus civil litigation with any detail. The purpose of this article is to simply point out that parties should not automatically presume that arbitration is always the preferred mechanism to litigate a construction dispute.