ARBITRATION OF CONSTRUCTION DISPUTES

by Jack Rephan

Arbitration of construction disputes is not new. Almost 135 years ago, arbitration was introduced into standard-form construction agreements and since that time arbitration has become an accepted method of resolving construction disputes. Although arbitration is a common law concept, statutory sanction of arbitration may be found in the United States Arbitration Act, 43 Stat. 883, 9 U.S.C. §1, *et seq.* (FAA) and in the Uniform Arbitration Act which has been adopted, in one form or another, by a majority of the states.

Federal policy has clearly favored the use of arbitration over litigation. This policy is also generally followed in the jurisdictions adopting the Uniform Arbitration Act Modern construction projects involve a multiplicity of parties, highly technical procedures, new techniques and the use of new types of materials. They require complex planning and scheduling and complex legal documents. The potential for controversy is ever present. With the increased usage of American Institute of Architects (AIA) standard form documents by owners, contractors and subcontractors, and inasmuch the arbitration clauses in such documents are enforceable under the Federal Arbitration Act and under the state arbitration statutes, more and more construction disputes are being resolved by arbitration. It should also be noted that the 1997 AIA documents also mandate mediation before the parties can resort to arbitration. Under the 2007 AIA Documents the parties are given the option to require arbitration at the time they enter into their agreement.

1. Arbitration Procedure. Where the contract contains a binding arbitration agreement, arbitration proceedings are instituted by filing a Demand for Arbitration with the appropriate regional office of the AAA within the time period specified in the contract. Although printed demand forms may be obtained from the AAA, the demand may be submitted in letter form. Only a very brief statement of the claim, the amount of money at issue, and the remedy sought is required. A copy of the agreement to arbitrate should accompany the demand for arbitration.

Absent a binding arbitration clause, the parties can also mutually agree to submit a dispute to arbitration in which case the matter will proceed in the same manner as in the case of a unilateral demand for arbitration. Submission forms may also be secured from the AAA.

The AAA charges an Initial Filing Fee and a Final Fee for claims and counterclaims whether the arbitration is initiated by demand or submission. As of July 15, 2015, these fees range from a minimum of an initial fee of $750 plus a final fee of $800 to an initial base fee of $10,000 plus .01% of the amount of the claim above $10 million with a cap of $65,000 and a final fee of $12,500. There is also a Flexible Fee Schedule where smaller Initial Filing Fees and Proceed Fees are required to be paid within 90 days of the filing of the demand or counterclaim, plus Final Fees in the same amounts as they are on the Standard Fee Schedule to be paid in advance of the first hearing. Only the Final Filing Fees on the Flexible Fee Schedule are refundable and only if the case is settled before any hearing.

Although an answer or response to the demand is not required unless the respondent

intends to counterclaim, the better practice is to respond and set out the reasons why the claim is being denied.

After any responses or counterclaims have been filed and the required filing fees have been paid, the AAA will submit to each party a list of arbitrators from which the panel to hear the arbitration will be selected. The list will contain occupational and educational information concerning each person on the list. After each party strikes from the list the names of the persons not acceptable, the AAA will appoint a panel of arbitrators from the remaining names. The panel will normally consist of one arbitrator, although the AAA may, in its discretion, appoint three arbitrators.

Because as any arbitration will most likely involve legal as well as architectural, engineering and other technical issues, it may be desirable to have at least one lawyer on the panel. Other panelists may be architects, engineers, contractors, subcontractors, contract administrators, etc.

With regard to the hearing locale, absent an agreement of the parties, or absent a contractual provision governing the place of the hearing, the arbitrator will determine the date, time and place where the hearing will be held.

Usually at the Preliminary Management Conference, the arbitrator will establish the time and date or dates for the hearing and, among other things, establish a date for an exchange of information and documents and a stipulation of uncontested facts so as to expedite the arbitration proceedings. A postponement may be obtained only for good cause shown.

No discovery, other than an exchange of exhibits and witness lists, is provided for under the Construction Industry Arbitration Rules. Discovery is often facilitated, however, by agreement of counsel.

A party may request an Administrative Conference before an arbitrator is appointed with a representative of the AAA and the other party or parties to discuss, among other things, ways to expedite the arbitration, discuss the parties' choice of an arbitrator, consider mediation as an option and to address any concerns of the parties.

Hearings are normally informal, although some formality may be adhered to, as necessary, in order to insure an orderly proceeding. At the hearing the parties may present such testimony or written evidence as they desire. The arbitrators may also request a party to present such additional evidence as the arbitrators deem necessary to reach an understanding and determination of the dispute. If the arbitrators are authorized by law to subpoena witnesses or documents, they may do so upon the request of a party. The arbitrators will rule on the admissibility of evidence and, since conformity to legal rules of evidence is not required, the panel generally will receive anything submitted. The taking of evidence or communicating with the arbitrator *ex parte* is, however, prohibited.

A rather unique feature of arbitration is that evidence may be introduced by affidavit as well as by testimony or documentary proof.

Unless one of the parties requests that a stenographic record be taken, none is required. The cost of such records is paid by the requesting party unless the parties agree otherwise.

After all evidence has been presented and after closing arguments of the parties, or the filing of briefs, if any, the arbitrators will declare the hearing closed. Briefs may or may not be required depending upon the desires of the parties or the determination of the arbitrators as to whether briefs are necessary.

Once the hearings are closed, the panel has 30 days within which to render an award unless an extension of time has been agreed to by both parties.

Although the arbitrators may grant any remedy or relief which is just and equitable and within the terms of the agreement of the parties, typically the award will simply be for a dollar amount. No reasons will be given as to the basis of the award, but there must be a breakdown as to how the amount was reached. The award will state whether or not administrative fees and costs are assessed against one party or another or are to be borne equally. Attorneys' fees will not normally be assessed against a party absent an agreement for the payment of attorneys' fees in the contract. The award will be signed by the arbitrator or arbitrators in the manner required by law.

2. Compelling Arbitration. No party may be compelled to submit a matter to arbitration unless he has first agreed to do so. Thus, the contract between the parties must be examined to determine whether there is a binding arbitration agreement. If the contract evidences "a transaction involving commerce" the arbitration agreement is enforceable under FAA. It must be also determined that the particular dispute is one which the parties have agreed to submit to arbitration.

The general rule that it is within the province of the courts to determine the threshold question of arbitrability, although if a court determines the parties have agreed to submit a dispute to arbitration, the arbitrators should have the opportunity to resolve in the first instance substantive and procedural issues growing out of the dispute there is some authorities which used that the parties may agree by the term of their contract that issues of arbitrarily are to be determined by the arbitrators. A party seeking to compel arbitration may therefore file suit pursuant to the applicable state statute, in which case the state court will have jurisdiction to determine all issues relative to the arbitrability of the dispute and enforce the arbitration agreement if it is determined to be enforceable. Alternatively, if the contract involved interstate commerce, resort may be had to an appropriate United States District Court under the Federal Arbitration Act provided a basis for independent federal jurisdiction exists. Notwithstanding the foregoing, if the contract requires that the arbitration be conducted under the current Construction Industry Rules of the AAA, the arbitrator or arbitrators have the power to rule on his or their jurisdiction and any objections with respect to the existence, scope or validity of the arbitration agreement.

3. Enforcing an Arbitration Award. Under many arbitration clauses and under most arbitration statutes, the parties are deemed to have consented to the entry of judgment upon an

award.

State courts may enter judgment on an award under the state arbitration statutes. In a suit to enforce an award, the opposing party may be required to set forth in his responsive pleading "good cause" why judgment should not be entered.

A party seeking to confirm an arbitration award in a federal district court premised on federal question jurisdiction or on diversity of citizenship jurisdiction must also establish that the contract evidences "a transaction involving [interstate or foreign] commerce." If jurisdiction is established and if the agreement provides for the entry of judgment on the award, the court may confirm the award. Any such application must, however, be made within one year after the award.

4. Setting Aside Arbitration Awards. Under most arbitration statutes, an award may not be set aside or vacated except for errors apparent on its face unless it appears to have been procured by corruption or undue means or there was partiality or misbehavior in the arbitrators.

The Supreme Court in *Hall Street Assoc., L.L.C. v. Mattel, Inc.,* 128 S, Ct. 1396 (2008), held that the grounds stated in the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 *et seq.*, constitute the *exclusive* grounds for expedited vacatur and modification of arbitration awards pursuant to the provisions of the FAA. 128 S.Ct. at 1400. [Emphasis added]. Following that decision, the federal courts have not been uniform in their opinions as to whether an award may be vacated for "manifest disregard of the law." Some of the federal circuits interpret *Hall Street* as holding that manifest disregard of the law is no longer available as a ground for vacating an award under the Federal Arbitration Act. Other federal circuits continue treat manifest disregard of the law as only shorthand for the statutory grounds for vacatur under §10 (a) of the FAA. One federal circuit holds that manifest disregard of the law remains as an independent ground for vacatur even after *Hall Street*. Two circuits have not yet ruled on the effect of *Hall Street* on manifest disregard as a ground for vacating or modifying an award. State law remains unaffected by *Hall Street,* and whether manifest disregard of the law is a ground for setting aside or modify an award is dependent upon the law of the state where review of an award is sought.

The FAA limits the power of the court to vacate an award to cases where the award was procured by corruption, fraud or undue means, where there was evident partiality or corruption in the arbitrators, where the arbitrators were guilty of enumerated examples of misconduct, or where the arbitrators exceed their powers. The Federal Act permits the court to modify an award to correct an evident material miscalculation of figures or mistake in description or where the arbitrators have awarded upon a matter not submitted to them.

In any proceedings wherein a party seeks to vacate an award there are certain basic principles or presumptions which will apply and which favor the upholding of the award.

Arbitration panels are viewed as courts of parties' own selection are favored by law, and every fair presumption is made to sustain their awards. Arbitrators will also be presumed to have acted within the terms of the submission. Therefore, in order to impeach an arbitrator's award it must be clearly shown that he exceeded his powers. Arbitration awards will not be set aside

unless they appear to be founded on clearly illegal grounds.

An arbitrator's award which is fraudulent or fraudulently induced may be set aside. Also, a failure to disclose any relationship the arbitrator may have with the parties, their council or any other person involved in the arbitration may be deemed misconduct sufficient to cause a vacating of an award. However, errors in the proceedings or conclusions of the arbitrator are not in themselves evidence of fraud. It must be shown that in reaching his conclusions the arbitrator was actuated by fraud. This cannot be done merely by claiming error in the arbitrator's findings of fact and designating said error as fraudulent. Something independent and outside of errors in an award must be shown to indicate that it was fraudulently obtained.

A mistake of fact, apparent upon the face of the award, renders the arbitrator's award invalid. However, calculations or grounds for an award, which are not incorporated in or annexed to it at the time of delivery, will not be considered.

An award will not be set aside because of an error in the judgment of the arbitrator; a mere difference of opinion between the court and the arbitrator in a doubtful case is not sufficient.

An award has been set aside where the arbitrator heard testimony from one party in the absence of the other, or the arbitrator received into evidence relevant documents from one party without the knowledge of the other party, or if the arbitrator refused to hear evidence impeaching the credibility of various witnesses. However, an award will not be set aside on the ground that improper testimony was admitted at the hearing where it is not apparent from the face of the arbitration award what evidence was acted on.

5. Conclusion. Arbitration has certain advantages over litigation. Disputes generally can be resolved in a more expeditious and less costly manner. Arbitration is less formal than litigation and is a private, rather than public proceeding. Arbitrators can be selected for their expertise in technical subjects whereas judges more often than not do not have expertise in such disciplines as architecture, engineering and construction. An award of an arbitrator has greater finality than the judgment of a lower court, a feature which may appeal to most businesses who wish to avoid lengthy and costly appeals of decisions of lower courts. Because of the presumption favoring the enforcement of an arbitration award, courts will very carefully review each case and the specific circumstances presented in each case in order to determine whether there was some occurrence in the proceedings of the arbitration requiring the invalidation of the arbitration award. For the most part, an arbitrator's decision based upon an erroneous determination of a question of fact, or an error on a point of law, will not cause a court to hold an award invalid. Evidence of fraud, corruption or misconduct by an arbitrator, or the issuance of an award exceeding an arbitrator's authority, must be presented to invalidate an award.

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This article was originally written in September 2011 and updated in February 2016.