

Construction Arbitration: The Pros and Cons

Written By **Jason T. Strickland** (jtstrickland@wardandsmith.com)

August 29, 2018



It's an unfortunate fact that many construction projects end in disputes, driving the parties into some form of dispute resolution.

Many of these construction disputes are resolved through arbitration, which is a process by which the parties in dispute, instead of going to court to resolve the matter, agree to submit their case to a third-party neutral, known as the arbitrator, who acts as a judge and jury.

How is Arbitration Different?

Arbitration is often confused with mediation and, sometimes, with a lawsuit. Each involves different forms of dispute resolution.

Mediation is a settlement conference in which the parties meet (typically in person) and use a third-party neutral to act as a settlement facilitator. The third-party neutral is called the mediator. Although the mediator has authority to conduct and administer the mediation, the mediator has no power to force or compel settlement. The parties submit their dispute to the mediator either because a court or a contract provision requires that they do so, or because they feel the mediator will be able to facilitate a settlement that might not otherwise be achieved without a mediator's assistance. However, ultimately, the parties can refuse to settle.

A lawsuit is conducted in a court of law and usually is initiated by a plaintiff filing a complaint, in which the plaintiff will ask for some form of relief from the defendant. The right for the parties to have their dispute adjudicated in a court is provided in state or national constitutions, or statutes passed by legislatures. The court where the lawsuit will take place is a government institution from which, by law, the parties are entitled to seek a decision as to their rights and obligations.

Arbitration is essentially a lawsuit but without court involvement. The parties agree (either in a contract before a dispute arises or, through a subsequent agreement to avoid a lawsuit) to submit their dispute to arbitration rather than to pursue a lawsuit in court. The parties' agreement gives the arbitrator the power to issue a decision as to the parties' rights and obligations, and such decision will be legally binding on all parties. Thus, arbitration is very different from mediation because the third-party neutral provides a legally binding decision. However, arbitration is not mutually exclusive with mediation. In many cases, parties will have a dispute resolution provision in their contract that will allow, or require, the parties to mediate first, and

if the mediation is unsuccessful, to then submit their dispute to arbitration.

The Major Differences Between Arbitration and Lawsuits

Because arbitration is primarily an alternative to a lawsuit, the two processes have similarities, but there are also stark differences. The following are the major distinctions between arbitration and litigation in court:

The Decision Maker and the Decision Process

In a lawsuit, the dispute is ultimately decided after a trial before a "finder of fact." The judge is a government employee who has the authority to oversee and administer the case and the trial. The judge decides questions of law. At trial, frequently a jury will decide the facts, although in some cases, the judge will determine both the law and the facts. The judge decides the law and applies the law to facts to reach the outcome.

In arbitration, the contract or agreement setting up the arbitration controls the process. The parties have great latitude to define the procedure and rules that will govern the arbitration. However, there are some limits to this latitude. For example, an arbitration clause that provides that the parties will flip a coin to decide the result will probably not be enforceable.

In arbitration, there is a private arbitrator (or a panel of private arbitrators) who acts as both the judge and the jury: administering the case, deciding the facts, and applying the law. Arbitration ends after an evidentiary hearing that is similar to a trial in a court of law.

Typically, the arbitrator is chosen by the parties (or, sometimes, by a court) based on the subject matter of the dispute. Thus, construction arbitration will likely have a construction lawyer or someone with extensive construction experience serving as the arbitrator. This reduces the time and effort necessary for the attorneys to "educate" the arbitrator on construction issues and makes the arbitrator better suited to render a decision in the case.

Unlike a construction specialist serving as an arbitrator, in a lawsuit, the judge is a generalist. Although the judge may have some experience hearing construction cases, it is likely that most of the cases the judge has heard are not related in any way to construction matters. Similarly, a typical juror will have little experience with the highly technical issues presented during construction arbitration.

Rules

Arbitration is intended to be less formal than a lawsuit. The rules of evidence and of civil procedure are typically not strictly enforced and an arbitrator has wide latitude to frame the process for conducting the arbitration. Because of this informality, disputes regarding process and rules commonly arise in arbitration. Generally, however, the parties, working with an arbitrator, will agree to a scheduling order that sets forth the deadlines, process, and rules for conducting the arbitration. This order will typically include provisions for how long the discovery period will last, where and when the evidentiary hearing will occur, the content of the arbitrator's final award, and the amount and type of discovery that will be allowed.

In a lawsuit, depending on the court in which the litigation is conducted, there are a set of rules (typically called the Rules of Civil Procedure) that dictate how the parties will conduct themselves and present their claims. Although these rules allow some limited flexibility, and although a judge will sometimes allow deviation from strict adherence to them, the Rules of Civil Procedure allow the parties less flexibility than

in arbitration.

Arbitrations tend to be (or, at least, are *intended* to be) a more efficient and economic means of dispute resolution. This is achieved by the less formal nature of arbitration and the ability of the parties and the arbitrator to craft a process for conducting an arbitration that is the most efficient for their particular needs, without regard to the formal rules of evidence or civil procedure. However, many parties (and/or their attorneys) frequently turn arbitration into what attorneys call "arbitigation" in which just as much discovery is conducted in arbitration as would be the case in litigation. Combined with the cost of the arbitrators, this can make arbitration as expensive, if not more expensive, than litigation.

Appeals

There is typically no appeal from an arbitrator's decision. This is primarily because appeals create significant costs and delays, the very things arbitration is designed to avoid. If a party believes that an arbitrator has made a mistake of law or determined facts incorrectly, it will be very difficult for the dissatisfied party to pursue an appeal of the arbitrator's award. The only real bases for asking a court to overturn an arbitrator's decision is fraud (the arbitrator took a bribe), bias (the arbitrator clearly evidenced an overt favoritism toward one of the parties), or that the arbitrator decided an issue that was not within the scope of the arbitration. These bases rarely exist and are even more rarely provable.

The lack of an appeal process in arbitration is good in the sense that a final result can be achieved more quickly and less expensively. It's bad in the sense that a party may be stuck with an undesirable result which is the product of an arbitrator's clearly erroneous decision. It's also bad because over the last couple of decades, as more and more construction cases are resolved with arbitration, there have been much fewer published court decisions on issues that are prevalent in the construction industry. Therefore, there is little or no precedent on these issues to guide even a diligent and thoughtful arbitrator.

In contrast to arbitration, in litigation, the parties can appeal the final decision of the trial court to an appeals court. Frequently there are multiple levels of appeals courts and, as a result, there can be multiple levels of appeal for any party dissatisfied with the outcome of a lawsuit. Unlike arbitration decisions, many appellate court decisions are published and available for precedential guidance.

The Ability to Add Additional Parties

Construction disputes routinely involve claims between nearly every party on the project at issue, and the number of such parties is often quite large. The ability to add parties to arbitration is more difficult than with a lawsuit. Arbitration is limited to those parties who have agreed to resolve their disputes through arbitration (and this agreement typically will only be easy to obtain at the beginning of a project when the project contract is being negotiated).

In a lawsuit, the parties can generally add other parties to the dispute so long as the court has jurisdiction over those parties. Such jurisdiction will generally exist if the party to be added lives in the state where the court sits or has substantial connections to that state—one or the other will probably exist if that party has agreed to join in a construction project. A lawsuit makes it much easier to join those parties. This is beneficial as, among other reasons, it avoids the potential for the inconsistent results that can occur if there are multiple separate arbitrations or lawsuits concerning the same subject matter.

In situations where some, but not all, of the parties to a lawsuit have an arbitration agreement, the judge will typically order the parties with the agreement to arbitrate and stay or suspend the lawsuit until the

arbitrating parties have finished their arbitration. This allows the judge to effectively "delegate out" to arbitration the part of the dispute that is between the parties subject to the arbitration agreement.

Recovery of Attorney and Other Fees

Attorney's fees are recoverable in arbitration if they would be recoverable in a matter of the same type in litigation. To be recoverable in litigation, there must be a statutory provision allowing for the recovery of attorneys' fees in that type of case or in the type of claims being asserted in that case. The North Carolina Revised Uniform Arbitration Act ("NCRUAA") also requires that the arbitration agreement include a provision authorizing an award of attorneys' fees. Therefore, arbitration, in and of itself, does not make it any easier to recover attorneys' (and other) fees than if the matter had been heard in a court of law.

Court Involvement in the Arbitration Process

Even with arbitration, it is likely that a court will be involved in some capacity. If one of the parties to an arbitration agreement refuses to engage in the arbitration, then a court can compel that party's participation. Absent a court exercising its inherent governmental power to compel arbitration, the recalcitrant party might refuse to honor its arbitration agreement and then the dispute would be forced into a lawsuit to resolve the issues—a development directly at odds with the parties' intent as evidenced in their agreement.

The court's ability to compel arbitration may be found in the Federal Arbitration Act ("FAA"), which applies to cases involving interstate commerce, and most construction cases fall under this definition. Basically, the FAA requires that agreements to arbitrate be honored and enforced. This allows a party seeking to enforce an arbitration clause to get the assistance of the federal courts to compel the other party to arbitrate. However, the FAA doesn't contain many, if any, specifics on the process for conducting the arbitration. Thus, if a party is relying solely on the FAA to enforce an arbitration agreement, the process and rules used in the arbitration will likely be drawn from the parties' arbitration agreement, directed by the court, or agreed to by the parties.

Many states, including North Carolina, have adopted some form of the Revised Uniform Arbitration Act. The NCRUAA functions much like the FAA. Importantly, however, the NCRUAA contains numerous procedural mechanisms for setting up and conducting arbitration. These include, among others, provisions on compelling parties to conduct an arbitration, appointing the arbitrator(s), staying pending court cases while the arbitration is conducted, seeking the court's assistance in conducting discovery, and enforcing an arbitration award in court. The FAA and NCRUAA ensure that if a valid arbitration agreement exists, it will be enforced regardless of whether a case is first filed in state or federal court.

Avoiding Unfavorable Local Law

Arbitration can also have the (arguably unintended) result of allowing the parties to avoid application of local substantive law on issues like evidence, jurisdiction, venue, and choice of law. This can occur because most federal courts have held that enforcing a requirement to arbitrate includes not only compelling arbitration, but also enforcing the process within the arbitration agreement by which the parties agreed the arbitration would be conducted. For example, if the parties agreed, in the contract, to "arbitrate any and all disputes arising from the contract in Wake County, North Carolina," then a court will likely hold that enforcing the arbitration agreement includes enforcing the requirement that the arbitration occur in Wake County—even if there is a state law providing that the particular dispute should not be heard in Wake County.

Thus, parties seeking to avoid particular state laws regarding venue and choice of law will include an

arbitration clause as a mechanism to allow them to choose a venue, choice of law, or other procedure or rule that would otherwise be barred by the applicable local state law. This is significant because the state statute, generally, would otherwise control over the terms of a contract. The state law can be avoided because the FAA pre-empts, or is superior to, a contrary state law and it allows the terms of the agreement to control.

A practical example of why a party might wish to rely upon the terms of the arbitration agreement in a construction contract is that many any large construction projects in North Carolina involve out-of-state general contractors. The out-of-state contractors prefer to litigate disputes with their subcontractors in the general contractor's home state, not in North Carolina. However, North Carolina has a statute that requires that a case involving a construction project in North Carolina be heard only in North Carolina courts with the application of North Carolina law. By including an arbitration clause in the construction contract providing a non-North Carolina venue, an out-of-state party can, in most cases, avoid the state law requiring the case be heard in North Carolina and instead have the matter heard in the party's home state.

Third Party Administration of Arbitration

Several different organizations administer arbitrations. The two most common are the American Arbitration Association ("AAA") and JAMS. These organizations serve as facilitators of the arbitration process and allow an arbitration to be conducted with even less court involvement. Use of these services will increase the cost and time of arbitration, but using one of these services can help to move the arbitration process along in cases where one of the parties is stonewalling. In most cases, in order for one of these services to be involved there must be a prior agreement to arbitrate that includes the requirement to use of one of these services.

Many standard form construction contracts contain arbitration clauses, and many of these clauses also require that AAA oversee the arbitration. Once a dispute arises, the parties will sometimes attempt to opt out of this requirement and arbitrate under the AAA Rules while waiving the requirement of AAA administration. The parties should be careful when doing this because the AAA rules require that AAA administration be included. At least one court decision holds that if the parties agree to administer their arbitration per the AAA rules, they are also agreeing to AAA administration of the arbitration.

Conclusion

Most parties involved in a construction project have a contract that defines their responsibilities and many of these construction contracts also contain arbitration clauses. Therefore, participants in the construction process must be aware of the pros and cons of arbitration.

--

© 2020 Ward and Smith, P.A. For further information regarding the issues described above, please contact Jason T. Strickland.

This article is not intended to give, and should not be relied upon for, legal advice in any particular circumstance or fact situation. No action should be taken in reliance upon the information contained in this article without obtaining the advice of an attorney.

We are your established legal network with offices in Asheville, Greenville, New Bern, Raleigh, and Wilmington, NC.