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Construction Newsletter

[Presented by the Law Offices of Ashley A. Baron]

Legal News for Construction Industry

To Arbitrate or Not To Arbitrate That Is The Question

Most owners, developers, general contractors, subcontractors and material supply houses have long believed that arbitration clauses in contracts made financial sense or just never thought about them at all. Virtually all form construction contracts including AIA and those drafted by attorneys in California which our firm has reviewed contain some form of arbitration clause. But do they make sense?

The traditional argument has been that arbitrations are much quicker, cost less and have a more experienced decision maker than court cases. But do they really?

Like beauty, the answer to that question, is often in the eye of the beholder. The cost is supposed to be less because arbitration is supposed to be quicker and involve less discovery than court cases. However, because the court system in California has gone to fast track requiring the majority of cases to go to trial within one year of filing they are often set for trial as fast or faster than arbitration cases.

Further, the appellate courts in California have stated that arbitrators cannot curtail discovery to the disadvantage of a party to the arbitration. Therefore, arbitrators are now allowing more discovery than they previously did so that there are no grounds for the courts to overturn the arbitration award once a final decision is reached. Thus, the time advantage argument does not favor arbitration the way it once did.

The second argument in favor of arbitration in construction cases is that it will be a less expensive alternative to trial in the court system. Arbitration in most cases is no longer the less expensive alternative. The principal arbitration service cited to perform the arbitration services in construction contracts is the American Arbitration Association. AAA requires an initial filing fee which varies from $775 for cases up to $10,000 and can go up to $12,800 plus .01% of the amount over $10,000,000 with a cap at $65,000,000.

The initial filing fee is only the start with AAA. The initial filing fee does not include the arbitrator's professional fees and expenses, which like attorneys, are billed on an hourly basis (usually ranging from $350 - $600 per hour) for each conference call, hearing, review of documents or day in arbitration. Such fees can mount up fast and while the prevailing party may be permitted under the contract to recoup these fees there is no guarantee that the arbitrators will award them to the prevailing party. Further, if a hearing room is required, the parties must bear the expense of renting it from either AAA or some other third party.

Likewise, JAMS, another large arbitration service that is provided for in many construction contracts, is also expensive. They charge a $1,000 per party non-refundable fee up front. They also charge an administrative fee of 10% of the profession arbitrator's fees. Like AAA the arbitrator's professional fees are billed hourly and range from $350 - $600 per hour.

By contrast, the civil court system is extremely affordable with a filing fee of a few hundred dollars, various minimal motion fees, court reporter fees and the taxpayers bearing the cost of the judge, jury and courtroom. Thus, the argument that arbitration is more affordable is no longer the case, if it ever was. Because lawsuits in years past dragged on for years and years, arbitration may have been more affordable then but now that argument has lost all merit.

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Another argument advanced as a reason to agree to arbitration in the contract is that it provides for less discovery (i.e. depositions, interrogatories, requests for production of documents and requests for admission). Even if this was still the case, which it has increasingly ceased to be, it prevents both sides from analyzing claims and information and can work to your disadvantage.

Appellate courts recognized this problem and are requiring that arbitration provide for enough discovery so that the parties to the arbitration can adequately be informed of the issues and defenses prior to conducting the arbitration. Thus, arbitrators are reluctant to sharply curtail discovery requests. Also, provisions for too limited discovery in either the arbitration agreement or the rules of arbitration could invalidate the agreement to arbitrate. It has been our experience that the idea that the arbitration will be more affordable and quicker because less discovery will be allowed is no longer viable.

It is often complained by parties to arbitration that arbitrators, rather than taking the hard line, would rather split the baby down the middle so there is no clear winner or loser. This may be true of judges and juries as well as arbitrators.

Another reason advanced for arbitration is that it is a more informal proceeding and the rules of evidence are relaxed if not completely disregarded. This allows the arbitrators to receive more information that may not have reached them if witnesses are unavailable or authentication of documents cannot be made. Again this makes it easier on the parties but provides the arbitrators with extraneous information upon with to base a result.

Arbitration waives your right to a jury trial. Everyone has a different opinion of juries and how effective they are at determining a proper result. Each party must understand that they are waiving this very important right when they sign a contract which provides for arbitration.

Arbitration has traditionally offered a more experienced decision maker. The panels that are available for construction disputes with most of the arbitration services do indeed provide arbitrators who have years of experience in construction disputes. However, most are not contractors, they are attorneys who have previously represented owners/developers or contractors and tend to have a tendency to look at a dispute through the filter of their own experience. While arbitrators on the construction panels may have more experience with construction than civil court judges, many if not all judges have experience with construction disputes.

Clients must decide if the high cost of arbitration is worth the incremental difference between construction arbitrators and civil court judges.

It has also been advanced that arbitration provides for the privacy of the dispute between the parties. While the specifics of the dispute are kept between the parties in arbitration there is no guarantee that one of the parties will not seek to vacate the arbitration award in a court of law, which would introduce much of the evidence into court and make it public. Clients must decide if the high cost of arbitration is worth the privacy rendered by arbitration.

For construction projects, the parties must decide, in advance, if all parties to subcontracts and material suppliers are going to be combined in any arbitration between the owner and general contractor. On large projects this can create an expensive process, especially for the subcontractors and material suppliers who may be owed nominal sums compared with the amount in dispute between the owner and general contractor. However, if the subcontractors and material suppliers are not combined in the arbitration between the owner and the general contractor there is the real possibility of inconsistent results where the general is awarded less against the owner than he owes the subcontractors and material suppliers.

Last, the arbitration process is supposed to offer a final result without the possibility of appeal. However, in recent years the courts of appeal have cut away allowing more review by the trial court to determine if the arbitrator "manifestly disregarded" the law. The crux of such review can be considered a retrial of the arbitration by the court and can delay entry of judgment and even force the parties to retry the matter.

While most owners, contractors and material suppliers continue to insert arbitration provisions in their contracts or ignore their inclusion in contracts they sign, they should think about the ramifications of including such a provision and make a decision whether arbitration really will benefit them or cost them too much.

We now have both Orange County and Park City Offices. Ashley Baron, a U.S.C. undergraduate and law school graduate, has been a lawyer for the past 29 years. Ms Baron has tried over 100 cases. The firm performs construction, business, labor law and litigation support for developers, prime contractors, material suppliers, subcontractors and other businesses in Orange, Riverside, San Bernardino and Los Angeles Counties. For further information contact us at (714) 974-1400 or e-mail us at ashleybaronesq@yahoo.com. You can now also go to our web site www.ashleybaron.com to read more about our firm or view our most recent newsletters.